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The Consumer Trust Fund: A Cy Pres Solution to Undistributed Funds in Consumer Class Actions

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Notes

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When a class of consumers settles or prevails in a class action, the funds collected from the defendant normally are used to cover individual damage claims, administrative costs, and attorney's fees. Despite the class representative's best efforts to notify all class members and solicit claims for damages, however, a pool of undistributed funds often remains.[1] For example, in the federal district court case of *West Virginia v. Chas. Pfizer & Co.*,[2] approximately $32 million remained unclaimed from a $100 million settlement.[3] In *In re Folding Carton Antitrust Litigation*,[4] $8 million remained in a "reserve fund" after a federal district court approved a $200 million settlement. Similarly, over $1 million in settlement funds remained unclaimed in the California Superior Court case of *Vasquez v. Avco Financial Services*.[5]

Surplus damages and settlement funds in class actions may remain undistributed for two reasons. First, funds may not be distributed be-

1. *In re* Folding Carton Antitrust Litig., 557 F. Supp. 1091, 1104 (N.D. Ill. 1983) ("In virtually every class action, there remains a reserve fund after all claims and expenses have been paid."), *aff'd*, 744 F.2d 1252 (7th Cir. 1984), *cert. dismissed*, 471 U.S. 1113 (1985); *see also* 2 H. NEWBERG, CLASS ACTIONS §§ 10.13-.14, at 370-72 (2d ed. 1985) (discussing the unclaimed balance of class recovery remaining after individual distribution and occasions when unclaimed balances arise).

2. 314 F. Supp. 710, 722-23, 734 (S.D.N.Y. 1970), *aff'd*, 440 F.2d 1079 (2d Cir.), *cert. denied*, 404 U.S. 871 (1971), *discussed in* T. BARTSH, F. BODDY, B. KING & P. THOMPSON, A CLASS ACTION SUIT THAT WORKED (1978) [hereinafter A CLASS ACTION SUIT THAT WORKED].

3. For a discussion of the settlement, see Note, *Collecting Overcharges from the Oil Companies: The Department of Energy's Restitutionary Obligation*, 32 STAN. L. REV. 1039, 1052-53 (1980) [hereinafter Note, *Collecting Overcharges*]; *see also* Note, Eisen v. Carlisle & Jacquelin—*Fluid Recovery, Minihearings and Notice in Class Actions*, 54 B.U.L. REV. 111, 119 (1974) [hereinafter Note, *Fluid Recovery*]; Note, *The* Cy Pres *Solution to the Damage Distribution Problems of Mass Class Actions*, 9 GA. L. REV. 893, 915 (1975) [hereinafter Note, *The* Cy Pres *Solution*]; Comment, *Manageability of Notice and Damage Calculation in Consumer Class Actions*, 70 MICH. L. REV. 338, 367-69 (1971); Note, *An Economic Analysis of Fluid Class Recovery Mechanisms*, 34 STAN. L. REV. 173, 180 (1981) [hereinafter Note, *An Economic Analysis*].

4. 557 F. Supp. 1091, 1097 (N.D. Ill. 1983), *aff'd*, 744 F.2d 1252 (7th Cir. 1984), *cert. dismissed*, 471 U.S. 1113 (1985).

5. No. NCC 11933 B (Los Angeles Super. Ct. Apr. 24, 1984) (order approving cy pres remedy).

cause all class members cannot be located and notified of their right to submit a claim for damages,[6] or because some class members fail to submit a claim.[7] Second, individual damages may be so small that notification and distribution costs exceed the recoverable amount or reduce it to a pittance.[8] In either event, the courts and attorneys are challenged with designing a distribution scheme that best benefits the uncompensated class members while minimizing management costs and judicial involvement.

In solving the problem of undistributed funds, courts have sometimes resorted to the cy pres doctrine, adapted from the law of trusts. The term "cy pres" is derived from the Norman French expression *cy pres comme possible*, which means "as near as possible."[9] Traditionally, the cy pres doctrine has been applied to preserve testamentary charitable gifts that otherwise would fail: if a charitable gift can no longer be carried out as the testator intended, the doctrine allows the "next best" use of the funds to satisfy the testator's intent "as near as possible."[10] In the class action context, cy pres mechanisms have become both useful and controversial means of distributing benefits to the "next best" class when injured class members, for whatever reason, cannot be compensated individually.[11]

6. For a discussion of this problem, see Berk, Daar v. Yellow Cab Co.: *The Advent of the Consumer Class Action in California*, 10 U.S.F. L. REV. 651, 651 n.5 (1976) (analyzing settlement in Daar v. Yellow Cab Co., 67 Cal. 2d 695, 433 P.2d 732, 63 Cal. Rptr. 724 (1967)).

7. *See, e.g., Folding Carton Antitrust Litig.*, 557 F. Supp. at 1104. Residual funds often remain due to both unascertainable and unresponsive class members in the same case. *Id.* at 1107-08.

8. *See, e.g.*, State v. Levi Strauss & Co., 41 Cal. 3d 460, 464, 715 P.2d 564, 565, 224 Cal. Rptr. 605, 606 (1986) (35 to 40 cent recovery per pair of jeans, with an average individual recovery of $2.60- $3.00); *see also* Cartt v. Superior Court, 50 Cal. App. 3d 960, 973, 124 Cal. Rptr. 376, 385 (1975) ("trifling" damages to individual consumers misled by defendant's advertising).

9. E. FISCH, THE CY PRES DOCTRINE IN THE UNITED STATES § 1000, at 1 (1950). The term "fluid recovery" sometimes is used synonymously with "cy pres" in the class action context, and the term also designates price reduction, which is one type of cy pres distribution mechanism.

10. *Id.*

11. *In re* "Agent Orange" Prod. Liab. Litig., 597 F. Supp. 740, 841 (E.D.N.Y. 1984) (Cy pres mechanisms are "regularly used as a settlement mode in consumer class actions."); *see, e.g., Folding Carton Antitrust Litig.*, 557 F. Supp. at 1104 ($8 million used to establish antitrust research foundation subject to superior equitable claims of nonclaiming class members); *In re* Three Mile Island Litig., 557 F. Supp. 96, 97 (M.D. Pa. 1982) ($5 million of a $25 million settlement earmarked for public health fund); *In re* Sugar Indus. Antitrust Litig., 73 F.R.D. 322, 354 (E.D. Pa. 1976) ("Classwide recovery of damages has been upheld in a number of disputes as being consistent with due process."); West Virginia v. Chas. Pfizer & Co., 314 F. Supp. 710, 728 (S.D.N.Y. 1970), *aff'd*, 440 F.2d 1079 (2d Cir.) (portion of settlement funds set aside for public health programs), *cert. denied*, 404 U.S. 871 (1971); Bebchick v. Public Utils. Comm'n, 318 F.2d 187, 203-04 (D.C. Cir.), *cert. denied*, 373 U.S. 913 (1963) (fund established on behalf of transit riders); State v. Levi Strauss & Co., 41 Cal. 3d 460, 479-80, 715 P.2d 564, 575-76, 224 Cal. Rptr. 605, 616-17 (1986) (damage fund divided among all claimants by lower

The consumer trust fund is one application of the cy pres doctrine in the distribution of excess or undistributable funds in consumer class actions. The primary goal of establishing a trust fund from undistributed settlement funds or judicially determined damages is to further the interests of absent class members.[12] Applying the cy pres doctrine to the distribution of settlement and damages recoveries in consumer class actions can also advance other public interests, such as deterring future unlawful practices by the defendant and disgorging the defendant's illegal profits to avoid unjust enrichment at the expense of consumers.[13] Competing against these goals, however, is the policy against conferring windfall benefits on unaggrieved individuals. In addition, cy pres mechanisms can potentially violate the due process rights of defendants. The tension among these conflicting policies and goals is the primary reason for the controversy surrounding the propriety of cy pres remedies in distributing settlement or damage funds.

This Note examines the use of the consumer trust fund as a distribution mechanism for settlement or damage funds in consumer class actions. Although this analysis is applicable to all jurisdictions,[14] this Note

court; remanded by California Supreme Court for disposition of residual funds); Cory v. Public Utils. Comm'n, 33 Cal. 3d 522, 528, 658 P.2d 749, 752-53, 189 Cal. Rptr. 386, 389-90 (1983) (unclaimed refunds should escheat to the state); Daar v. Yellow Cab Co., 67 Cal. 2d 695, 433 P.2d 732, 63 Cal. Rptr. 724 (1967) (taxicab fares lowered until illegal profits disgorged); Market St. Ry. v. Railroad Comm'n, 28 Cal. 2d 363, 373, 171 P.2d 875, 881 (although not a class action, undistributed overcharges collected from the railway were given to the City of San Francisco to finance repairs to the railway, which it had recently acquired), *cert. denied*, 329 U.S. 793 (1946); Vasquez v. Avco Fin. Servs., No. NCC 11933 B (Los Angeles Super. Ct. Apr. 24, 1984) ($1.4 million in undistributed funds entrusted to Consumers Union of United States, Inc., West Coast Regional Office to use for projects in the public interest). *But see, e.g.*, Windham v. American Brands, Inc., 565 F.2d 59, 72 (4th Cir. 1977) (denying aggregation of damages as a means of rendering class more manageable for certification), *cert. denied*, 435 U.S. 968 (1978); Eisen v. Carlisle & Jacquelin, 479 F.2d 1005, 1018 (2d Cir. 1973) (fluid recovery held to be "illegal, inadmissible as a solution of the manageability problems of class actions and wholly improper"), *vacated on other grounds*, 417 U.S. 156 (1974) [hereinafter *Eisen III*]; Al Barnett & Son, Inc. v. Outboard Marine Corp., 64 F.R.D. 43, 55-56 (D. Del. 1974) (antitrust case in which fluid recovery held to erode due process); Handler, *Twenty-Fourth Annual Antitrust Review*, 72 COLUM. L. REV. 1, 41 (1972) (" 'fluid class' concept extends judicial power beyond that point that the law permits or that wisdom would allow."); Malina, *Fluid Class Recovery as a Consumer Remedy in Antitrust Cases*, 47 N.Y.U. L. REV. 477, 492-93 (1972) (fluid recovery considered improper in cases brought under the Clayton Antitrust Act).

12. For example, the settlement of Vasquez v. Avco Fin. Servs., No. NCC 11933 B (Los Angeles Super. Ct. Apr. 24, 1984), provided for undistributed funds to be awarded to Consumers Union of United States, Inc., West Coast Regional Office, to benefit those who otherwise would have received a refund. *See infra* notes 183-90 and accompanying text.

13. Simer v. Rios, 661 F.2d 655, 675-77 (7th Cir. 1981), *cert. denied*, 456 U.S. 917 (1982).

14. No state expressly prohibits cy pres distribution, and three states authorize it by statute: Iowa, IOWA R. CIV. P. 42.1-.20, New Jersey, N.J. CIV. P. R. 4:32-2(c), and North Dakota, N.D. R. CIV. P. 23(o)(3)(E). The California Supreme Court approved the consumer trust fund in State v. Levi Strauss & Co., 41 Cal. 3d 460, 715 P.2d 564, 224 Cal. Rptr. 605 (1986). Case law in Arizona and New York, however, does provide precedent for disallowing

focuses on California and federal courts. Section I provides a brief overview of class action procedures, focusing on Federal Rule of Civil Procedure 23 and California class action statutes. Section II examines three specific applications of the cy pres doctrine—governmental escheat, price reduction, and claimant fund-sharing—as they apply to the distribution of settlement and damage funds in consumer class actions. Finally, section III examines the consumer trust fund and its effectiveness in comparison with the three cy pres mechanisms discussed in the previous section. This Note argues that the consumer trust fund should be used creatively for the "next best" distribution of funds that remain in consumer class action settlements and damage awards. The Note demonstrates that, compared with alternative distribution schemes, the consumer trust fund provides the best long-term results to class members of all socioeconomic groups, without disruption of the marketplace and with a minimum of judicial involvement.

I. Overview of Class Actions

A. History and Purpose

The class action originated in the English courts of chancery with the "bill of peace." A creature of equity, the bill of peace allowed a representative of a group of similarly injured persons to bring suit on behalf of absent class members as well as herself. Today, although it is available in actions at law, the class action remains an equitable device and enjoys equity's flexible approach to remedies.[15]

When a number of consumers has been harmed similarly by a defendant, especially when the economic injury to each plaintiff is small, a consumer class action is often the most effective device for recovering damages and deterring the defendant from continuing the unlawful practice.[16] Consumer class actions make it feasible to bring claims that, indi-

cy pres distribution mechanisms. *See* Reader v. Magna-Superior Copper Co., 110 Ariz. 115, 116-17, 15 P.2d 860, 861-62 (1973); Schimmel v. Reed, 50 A.D.2d 1085, 1086, 377 N.Y.S.2d 313, 314 (1975), *aff'd*, 40 N.Y.2d 887, 357 N.E.2d 1016, 389 N.Y.S.2d 361 (1976).

15. D. DOBBS, REMEDIES § 2.1 (1973); J. FRIEDENTHAL, M. KANE & A. MILLER, CIVIL PROCEDURE § 16.1, at 723 (1985); *see also* Hansberry v. Lee, 311 U.S. 32, 41-42 (1940) ("The class suit was an invention of equity to enable it to proceed to a decree in suits where the number of those interests in the subject of the litigation is so great that their joinder as parties in conformity to the usual rules of procedure is impracticable.").

16. *See, e.g.*, Vasquez v. Superior Court, 4 Cal. 3d 800, 807-08, 484 P.2d 964, 968-69, 94 Cal. Rptr. 796, 800-01 (1971):

> Frequently numerous consumers are exposed to the same dubious practice by the same seller so that proof of the prevalence of the practice as to one consumer would provide proof for all. Individual actions by each of the defrauded consumers is often impracticable because the amount of individual recovery would be insufficient to justify bringing a separate action; thus an unscrupulous seller retains the benefits of its wrongful conduct. A class action by consumers produces several salutary by-products, including a therapeutic effect upon those sellers who indulge in

vidually, might cost more to litigate than the amount of possible recovery. Consumer class actions also conserve judicial resources by avoiding multiple suits by individual consumers against the same defendant,[17] and they may also allow a defendant to assert res judicata against subsequent claims by class members.[18]

Although federal and state class action statutes vary, they all follow a general procedural pattern. The court first must determine whether the class is eligible for certification. Once the class is certified, the court must oversee notification of the absent class members, determine the defendant's liability,[19] assess damages, and decide how the recovery will be distributed.[20] If the class action is settled after certification, the court must approve the settlement.[21]

B. Consumer Class Actions in Federal Court

For a class action to be certified under Federal Rule of Civil Procedure 23, four prerequisites must be met.[22] In addition, the action must be classified as one of three types described in Rule 23(b).[23] When a consumer class seeks damages from the defendant, it brings a class action

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fraudulent practices, aid to legitimate business enterprises by curtailing illegitimate competition, and avoidance to the judicial process of the burden of multiple litigation involving identical claims.

17. Of course, class members who opt out can bring their own claims against the defendant. Opting out is unlikely, however, when individual claims are so small that they do not warrant individual suits.

18. Supreme Tribe of Ben-Hur v. Cauble, 255 U.S. 356, 367 (1921) ("If the federal courts are to have the jurisdiction in class suits to which they are obviously entitled, the decree when rendered must bind all of the class properly represented."). Res judicata is not guaranteed the defendant, however. The advisory committee's notes to Federal Rule of Civil Procedure 23 show that the drafters of the 1966 amendments, in spite of their concern for res judicata, recognized that a court cannot predetermine the res judicata effect of its judgment; it can only be determined in a subsequent action. *See* Cartt v. Superior Court, 50 Cal. App. 3d 960, 968 n.12, 124 Cal. Rptr. 376, 381 n.12 (1975).

19. For purposes of this discussion, it is assumed that both the plaintiff class and the defendants have waived any jury trial rights that may have been available.

20. When a cy pres distribution mechanism is employed, the question is whether only individual claims will be paid, the entire fund will be used in a cy pres fashion, or a combination of the two will be used.

21. *See, e.g.*, FED. R. CIV. P. 23(e).

22. Federal Rule of Civil Procedure 23(a) states:

> One or more members of a class may sue or be sued as representative parties on behalf of all only if (1) the class is so numerous that joinder of all members is impracticable, (2) there are questions of law or fact common to the class, (3) the claims or defenses of the representative parties are typical of the claims or defenses of the class, and (4) the representative parties will fairly and adequately protect the interests of the class.

23. Federal Rule of Civil Procedure 23(b)(1) pertains to actions in which individual adjudications could adversely affect the class or the defendant. Rule 23(b)(2) applies to parties seeking injunctive or declaratory relief, while 23(b)(3) applies to parties seeking damages.

under Rule 23(b)(3), and the court must find that a class action is "superior to other available methods for the fair and efficient adjudication of the controversy."[24] Such a finding requires that the court consider the "difficulties likely to be encountered in the management of a class action."[25] When the membership of a class is large or continuously changing—that is, "fluid"—or the individual damages are relatively small, concerns about management difficulties in providing adequate notice to class members and in distributing damages may lead a court to deny certification.[26] While the possibility of employing a cy pres method of distribution may be a deciding factor in convincing a state court that a class action is manageable,[27] federal courts have taken a dim view of fluid recovery, beginning with a vehement Second Circuit decision, *Eisen v. Carlisle & Jacquelin (Eisen III)*.[28] However, one critic of cy pres concedes that "without this innovation [cy pres distribution] some of the more expansive class suits will have to be rejected as inherently unmanageable. As a result, some legally cognizable injuries, which may be

24. FED. R. CIV. P. 23(b)(3).

25. *Id.* 23(b)(3)(D).

26. *See* Turoff v. Union Oil Co., 61 F.R.D. 51, 54 (N.D. Ohio 1973) ("[T]he cost of administering the recovery in a given case compared with the size of the recovery may be considered by the Court in determining whether a class action would be superior."). *But see* Kohn & Kaplan, *The Antitrust Class Suit: A Manageable Instrument for Social Justice,* 41 ANTITRUST L.J. 292, 298 (1972) ("To fail to certify a class because some claimants may not come forward, likewise permits defendants to retain all of their ill gotten profits. It defeats the very deterrent goal that has led the Supreme Court to characterize the private suit as a 'bulwark of antitrust enforcement.' ") (quoting Perma Life Mufflers, Inc. v. International Parts Corp., 392 U.S. 134, 139 (1968)).

Judge Miles W. Lord, in *In re* Coordinated Pretrial Proceedings in Antibiotics Antitrust Actions, 333 F. Supp. 278 (S.D.N.Y. 1971), stated:

> Difficulties in management are of significance only if they make the class action a *less* 'fair and efficient' method of adjudication than other available techniques. This perspective is particularly important . . . where the defendants, after reciting potential manageability problems, seem to conclude that no remedy is better than an imperfect one.

Id. at 282 (emphasis in original); *see also* Blue Chip Stamps v. Superior Court, 18 Cal. 3d 381, 389 n.3, 556 P.2d 755, 761 n.3, 134 Cal. Rptr. 393, 399 n.3 (1976) (Tobriner, J., concurring):

> No class action is inherently unmanageable; a court always has access to a variety of techniques, for example, for reducing the costs of giving notice to class members or for distributing relief. The critical question . . . is whether the techniques necessary to render a class action manageable are unconstitutional, or so distort the values a particular cause of action is meant to further that class suit would be improper.

27. *See* 3 H. NEWBERG, *supra* note 1, § 13.45, at 87-89.

28. 479 F.2d 1005 (2d Cir. 1973), *vacated on other grounds,* 417 U.S. 156 (1974); *see also* Windham v. American Brands, 565 F.2d 59, 72 (4th Cir. 1977) (following *Eisen III,* disallowed aggregation of damages, referred to as "fluid recovery"); *In re* Hotel Tel. Charges, 500 F.2d 86, 89-90 (9th Cir. 1974) (following *Eisen III*); *In re* Indus. Gas Antitrust Litig., 100 F.R.D. 280, 301 (N.D. Ill. 1983) (any form of fluid recovery held to be improper under the Clayton Antitrust Act).

small individually, but large in the aggregate, will go uncompensated."[29]

C. Consumer Class Actions in California

Under California law, consumers may bring class actions in three ways. California's pithy class action statute states that "when the question is one of a common or general interest, of many persons, or when the parties are numerous, and it is impracticable to bring them all before the court, one or more may sue or defend for the benefit of all."[30] Apart from this statute, a class may bring suit under the Consumers Legal Remedy Act.[31] The California Supreme Court has suggested use of this Act's procedural provisions to simplify class action litigation in the interests of efficiency.[32] The third option is to bring a representative action under the unfair competition and false advertising laws.[33]

The California judiciary looks much more kindly upon class actions than do the federal courts.[34] California courts are more sympathetic to plaintiffs' interests than are federal courts in approaching the problem of providing adequate notice to class members,[35] even allowing the courts to require that the defendant pay all or part of notification costs.[36] In-

29. Handler, *supra* note 11, at 41.

30. CAL. CIV. PROC. CODE § 382 (West 1973).

31. CAL. CIV. CODE §§ 1750-1784 (West 1985). The four prerequisites to certification are very similar to those of Federal Rule of Civil Procedure 23(a):

> The court shall permit the suit to be maintained on behalf of all members of the represented class if all of the following conditions exist:
>
> 1) It is impracticable to bring all members of the class before the court.
>
> 2) The questions of law or fact common to the class are substantially similar and predominate over the questions affecting the individual members.
>
> 3) The claims or defenses of the representative plaintiffs are typical of the claims or defenses of the class.
>
> 4) The representative plaintiffs will fairly and adequately protect the interests of the class.

Id. § 1781(b).

32. Vasquez v. Superior Court, 4 Cal. 3d 800, 820, 484 P.2d 964, 977, 94 Cal. Rptr. 796, 809 (1971).

33. CAL. BUS. & PROF. CODE §§ 17200-17208, 17500-17560 (West 1964 & Supp. 1986).

34. Cartt v. Superior Court, 50 Cal. App. 3d 960, 970 n.17, 124 Cal. Rptr. 376, 383 n.17 (1975) ("The apparent federal distaste for consumer class actions is not reflected in California."); *see also* Vasquez v. Superior Court, 4 Cal. 3d 800, 808-09, 484 P.2d 964, 968-69, 94 Cal. Rptr. 796, 800-01 (1971) (discussing the importance of class actions as a tool for the injured consumer).

35. The United States Supreme Court has held that under Federal Rule of Civil Procedure 23(b)(3) plaintiffs must provide notice to every class member identifiable through reasonable effort. Eisen v. Carlisle & Jacquelin, 417 U.S. 156, 173 (1974). California courts require individual notice only when class members have a substantial claim and allow notice by publication when the class is very large and the damages are small. *See* 48 CAL. JUR. 3D *Parties* § 42 (1979).

36. The Consumers Legal Remedies Act states that the court

> may direct either party to notify each member of the class of the action. The party required to serve notice may, . . . if personal notification is unreasonably expensive or

deed, the California Supreme Court has called the consumer class action "an essential tool for the protection of consumers against exploitative business practices."[37]

The California Supreme Court has advised trial courts to use the class action procedures of the Federal Rules of Civil Procedure as constructional aids if state authority is not controlling.[38] In *Cartt v. Superior Court*,[39] however, a California appellate court noted that although the California Supreme Court "has repeatedly referred to Rule 23 as a useful tool it has never adopted it as a procedural strait jacket. To the contrary, trial courts [have] been urged to exercise pragmatism and flexibility in dealing with class actions."[40] It is this "pragmatism and flexibility" that has led California courts to be largely sympathetic to class actions brought on behalf of consumers.[41]

D. Assessment of Damages

After determining liability, both federal and California courts generally assess damages in one of two ways. The first method is the traditional trial in which each class member's damage claim is tried separately.[42] Such proceedings are likely to place a severe burden on the time and resources of both the court and the defendant when the class size is great and the amount of damages is small.[43] In addition, the time and expense of individual trials can deter plaintiffs from pursuing small damage claims.

The second alternative for assessing damages involves aggregating the claims of all class members.[44] This method not only eases judicial

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it appears that all members of the class cannot be notified personally, give notice as prescribed herein by publication . . . in a newspaper of general circulation in the county in which the transaction occurred.

CAL. CIV. CODE § 1781(d) (West 1985).

37. State v. Levi Strauss & Co., 41 Cal. 3d 460, 471, 715 P.2d 564, 570, 224 Cal. Rptr. 605, 611 (1986).

38. Vasquez v. Superior Court, 4 Cal. 3d 800, 821, 484 P.2d 964, 977-78, 94 Cal. Rptr. 796, 809-10 ("In the event of a hiatus, rule 23 of the Federal Rules of Civil Procedure prescribes procedural devices which a trial court may find useful.") (citing Daar v. Yellow Cab Co., 67 Cal. 2d 695, 709, 433 P.2d 732, 742-43, 63 Cal. Rptr. 724, 734-35 (1967)); 48 CAL JUR. 3D *Parties* § 41 (1979).

39. 50 Cal. App. 3d 960, 124 Cal. Rptr. 376 (1975).

40. *Id.* at 970 n.16, 124 Cal. Rptr. at 383 n.16 (citations omitted).

41. *See* Berk, *supra* note 6, at 651 ("Mr. Justice Sullivan's opinion in *Daar v. Yellow Cab Co.* may be identified as signaling the advent of the large consumer class action in California.") (footnotes omitted).

42. 2 H. NEWBERG, *supra* note 1, § 9.53, at 320 n.361.

43. *See, e.g., In re* Hotel Tel. Charges, 500 F. 2d 86, 89 (9th Cir. 1974) (class consisted of 40 million persons who patronized various hotels that allegedly conspired to fix prices; proof of individual claims would take "approximately one hundred years" even if only 10% of the claimants came forward and used only 10 minutes per individual claim hearing).

44. J. FRIEDENTHAL, M. KANE & A. MILLER, *supra* note 15, § 16.5, at 747 & n.32.

management of the class action by eliminating individual damage trials, but also deters future unlawful conduct and ensures that the defendant does not retain unlawfully gained profits.[45]

After collecting the lump sum, the court can decide to distribute the funds in two different ways. First, the court can distribute the entire sum by dividing it among all the claimants (claimant fund-sharing), by reducing the price of the defendant's goods or services until the sum is "disgorged" (price reduction), by allowing the funds to escheat to the state, or by using a consumer trust fund. The second method of distributing the aggregate sum collected on behalf of the consumer class is to pay individual claims submitted by class members, and to place any residual funds in the hands of trustees (the consumer trust fund) or allow them to escheat to the government.

The next section of this Note examines the arguments for and against the use of the cy pres doctrine in damage distribution. It then discusses the various mechanisms that have emerged to cope with the problem of residual funds or aggregate sums of small recoveries.

II. Cy Pres Distribution Mechanisms

A. Overview

In the context of consumer class actions, the cy pres doctrine permits the "next best" use of settlement or damage funds that cannot feasibly be distributed to individual plaintiffs. As noted, distribution problems may arise when plaintiffs cannot be located or fail to submit claims, or when the costs of distribution exceed or reduce to a pittance the amount of recovery per individual plaintiff. Four cy pres distribution mechanisms are discussed in detail below. Before examining these mechanisms, this subsection provides a history of cy pres in the context of damages distribution, and the arguments for and against its application in the context of class actions.

(1) California Courts

California courts have been in the vanguard in applying cy pres dis-

Critics of claims aggregation view the procedure as a violation of defendants' due process rights. *See infra* notes 98-113 and accompanying text.

45. To determine the aggregate amount of class members' damages, the courts may rely upon the defendant's business records, J. FRIEDENTHAL, M. KANE & A. MILLER, *supra* note 15, § 16.5, at 747 & n.32, or upon a formula used to calculate the total damages suffered by the class. In either case, a lump sum is collected on behalf of the class. *See* Devidian v. Automotive Serv. Dealers Ass'n, 35 Cal. App. 3d 978, 982-83, 111 Cal. Rptr. 228, 230-32 (1973); *see also In re* Coordinated Pretrial Proceedings in Antibiotics Antitrust Actions, 333 F. Supp. 278, 281 (S.D.N.Y. 1971) (Judge Lord stated that "[i]t is far simpler to prove the amount of damage to the members of the class by establishing their total damages than by collecting and aggregating individual claims as a sum to be assessed against the defendants.").

tribution mechanisms.[46] The earliest case to apply the "next best" reasoning, although not a class action, was the California Supreme Court's decision in *Market Street Railway v. Railroad Commission*.[47] In that case, transit overcharges that could not be distributed to injured parties were awarded to the City and County of San Francisco to help finance repairs to the railway, which the city recently had acquired. Despite the state's escheat claim to the fund, the court chose the cy pres remedy because it would indirectly benefit all railroad users who had paid the excessive fares.[48] The court declared that it had the "duty and responsibility . . . to use broad discretion" in using the fund "to avoid an unlawful or unjust result."[49]

In another non-class action applying the *Market Street Railway* reasoning, *Olson v. County of Sacramento*,[50] a California appellate court stated that if it was "impractical to distribute any recovery" to persons who had paid for refuse collection under a void contract, the money could "be used in other respects for the benefit of the county's householders."[51]

In *Daar v. Yellow Cab Co.*,[52] a California trial court approved a settlement designed to redistribute alleged overcharges of taxicab fares by lowering fares for the benefit of future riders.[53] The class was "fluid" because there was no direct correlation between taxicab users who would benefit from the reduced fares and those who were injured by the overcharges. Thus, California courts began to recognize the idea of using settlement monies or unclaimed damages funds for the "next best" use of the injured class. Finally, in *State v. Levi Strauss & Co.*,[54] the California Supreme Court endorsed the concept of cy pres distribution mechanisms and drafted its opinion "as a source of guidance" for trial courts in their discretionary application of these mechanisms.[55]

(2) Federal Courts

While California courts generally have supported the use of cy pres, federal courts have been less enthusiastic. The most serious attack in the federal courts on the cy pres concept was the Second Circuit's 1973 deci-

46. J. FRIEDENTHAL, M. KANE & A. MILLER, *supra* note 15, § 16.5, at 747.

47. 28 Cal. 2d 363, 171 P.2d 875, *cert. denied*, 329 U.S. 793 (1946).

48. *Id.* at 371-73, 171 P.2d at 880-82.

49. *Id.* at 367, 171 P.2d at 878 (citing United States v. Morgan, 307 U.S. 183, 194 (1939)).

50. 274 Cal. App. 2d 316, 79 Cal. Rptr. 140 (1969).

51. *Id.* at 326, 79 Cal. Rptr. at 145.

52. 67 Cal. 2d 695, 433 P.2d 732, 63 Cal. Rptr. 724 (1967).

53. For an excellent summary of the *Daar* settlement, see Berk, *supra* note 6, at 651-52 n.5. The settlement is not discussed in the court's opinion.

54. 41 Cal. 3d 460, 715 P.2d 564, 224 Cal. Rptr. 605 (1986).

55. *Id.* at 479, 715 P.2d at 576, 224 Cal. Rptr. at 617.

sion in *Eisen v. Carlisle & Jacquelin* (*Eisen III*).[56] The *Eisen* litigation was brought on behalf of purchasers and sellers of odd-lot shares of stock on the New York Stock Exchange. The suit alleged a conspiracy to monopolize odd-lot trading to fix the odd-lot price differential in violation of the Sherman Antitrust Act.[57] The district court dismissed the action and, on appeal, the Second Circuit reversed and remanded.[58] On remand, the district court determined that the suit was manageable, that if liability were established an aggregate damage fund could be assessed, and that excess funds could be distributed by reducing profits on future odd-lot transactions until the illegal profits were disgorged.[59] On appeal, the *Eisen III* court held price reduction to be improper and, in dictum, found it to be a violation of due process.[60] The United States Supreme Court, in *Eisen IV*, declined to rule on the legality of price reduction.[61]

Although the *Eisen III* decision has been roundly criticized,[62] the Fourth and Ninth Circuits have relied on it to disallow cy pres distribu-

56. 479 F.2d 1005 (2d Cir. 1973), *vacated on other grounds*, 417 U.S. 156 (1974).

57. Eisen v. Carlisle & Jacquelin, 41 F.R.D. 147 (S.D.N.Y. 1966); *see* 15 U.S.C. § 1 (1982).

58. Eisen v. Carlisle & Jacquelin, 391 F.2d 555 (2d Cir. 1968) *(Eisen II)*.

59. Eisen v. Carlisle & Jacquelin, 52 F.R.D. 253 (S.D.N.Y. 1971).

60. *Eisen III*, 479 F.2d at 1018.

61. Eisen v. Carlisle & Jacquelin, 417 U.S. 156, 172 n.10 (1974). For a good history of the cases up to *Eisen III*, see Note, *Managing the Large Class Action:* Eisen v. Carlisle & Jacquelin, 87 HARV. L. REV. 426, 428-33 (1973).

62. *E.g., Eisen III*, 479 F.2d at 1022 (Oakes, J., dissenting) ("The panel opinion . . . give[s] a green light to monopolies and conglomerates who deal in quantity items selling at small prices to proceed to violate the antitrust laws, unhampered by any realistic threat of private consumer civil proceedings . . . ."); Bruno v. Superior Court, 127 Cal. App. 3d 120, 128, 179 Cal. Rptr. 342, 346 (1981) ("*Eisen* and its progeny are not persuasive."); 2 H. NEWBERG, *supra* note 1, § 10.22, at 385-86 (*Eisen III*'s rejection of cy pres as an unlawful windfall "was in effect a ruling that it was better for the class to receive no compensation than to receive imperfect compensation because benefits to third-party strangers could not be avoided. This rationale is defective and is inconsistent with the historic purposes of class action remedies."); Landers, *Of Legalized Blackmail and Legalized Theft: Consumer Class Actions and the Substance-Procedure Dilemma*, 47 S. CAL. L. REV. 842, 873-74 (1974) (discussing the court's lack of clarity); McCall, *Due Process and Consumer Protection: Concepts and Realities in Procedure and Substance—Class Action Issues*, 25 HASTINGS L.J. 1351, 1403-04 (1974) (describing the court's rationale as "unenlightening," and the asserted constitutional violation a "fiction"); *Developments in the Law—Class Actions*, 89 HARV. L. REV. 1319, 1533 (1976) ("*Eisen III* failed to provide a convincing basis for rejecting . . . fluid distribution in antitrust class actions.") [hereinafter *Developments in the Law*]; Note, *Fluid Recovery, supra* note 3, at 120 (criticizing the *Eisen III* court's rejection of precedent); Note, *supra* note 61, at 451 ("The above considerations suggest that the *Eisen III* court was incorrect in holding that the fluid recovery . . . was not authorized by rule 23 . . . ."); Note, *Due Process and Fluid Recovery*, 53 OR. L. REV. 225, 232 (1974) ("Without citing any cases or making any argument, the court characterized fluid recovery as [unconstitutional]."); Case Note, *Class Actions—Federal Rules of Civil Procedure—Stringent Notice Requirement and Rejection of the Fluid Class Recovery Severely Limit Utility of the Class Action*, 27 RUTGERS L. REV. 212, 213 ("The *Eisen III* decision represents a direct repudiation of the theory that Rule 23 was amended to encourage and facilitate consumer class actions.").

tion.[63] Although federal courts impose more barriers to bringing consumer class actions than the California courts,[64] cy pres distribution mechanisms can be useful at least in the context of settlements of federal cases.[65] Cy pres remains a useful tool for consumer class actions in the generally more hospitable environment of state courts, although it is most commonly used in the distribution of settlement funds.[66]

B. Benefits of Cy Pres Distribution Mechanisms

The primary benefit of cy pres distribution mechanisms is their potential for serving three fundamental goals. First, the entire amount recovered can be distributed, leaving nothing to revert to the defendant. Full distribution of the recovery satisfies the policy of disgorging illegally obtained profits.[67] Second, courts are more likely to certify class actions and allow them to go forward on the merits when such mechanisms are available, because they make the distribution of funds a manageable task. The likelihood of class certification, coupled with disgorgement of all illegally obtained profits, provides a deterrent to defendants contemplating unlawful conduct. Finally, the cy pres doctrine provides compensation to the maximum number of class members by the nature of its "next best" application.

63. *E.g.*, Windham v. American Brands, Inc., 565 F.2d 59, 72 & n.41 (4th Cir. 1977) (price fixing), *cert. denied*, 435 U.S. 968 (1978); Kline v. Coldwell Banker & Co., 508 F.2d 226, 233-34 (9th Cir. 1974) (same), *cert. denied*, 421 U.S. 963 (1975); *In re* Hotel Tel. Charges, 500 F.2d 86, 90 (9th Cir. 1974) (unlawful overcharges).

64. The *Eisen IV* Court required individual notice in Rule 23(b)(3) actions. 417 U.S. at 173. *Snyder v. Harris* disallowed the aggregation of claims for diversity jurisdiction, requiring that each 23(b)(3) class member satisfy the $10,000 amount-in-controversy requirement. 394 U.S. 332, 339-42 (1969). The *Snyder* limitation does not affect class actions arising under federal law. *See* Malina, *supra* note 11, at 492-93.

65. *E.g., In re* Folding Carton Antitrust Litig., 557 F. Supp. 1091 (N.D. Ill. 1983), *aff'd*, 744 F.2d 1252 (7th Cir. 1984), *cert. dismissed*, 471 U.S. 1113 (1985); *In re* Three Mile Island Litig., 557 F. Supp. 96 (M.D. Pa. 1982); West Virginia v. Chas. Pfizer & Co., 314 F. Supp. 710 (S.D.N.Y. 1970), *aff'd*, 440 F.2d 1079 (2d Cir.), *cert. denied*, 404 U.S. 871 (1971).

66. J. FRIEDENTHAL, M. KANE & A. MILLER, *supra* note 15, § 16.5, at 747-48.

67. Thus, the cy pres mechanism effectively serves a purpose similar to that of a constructive trust. A constructive trust is imposed on one who has unlawfully acquired the property of another, and requires that the property be removed from her possession. *See generally* 76 AM. JUR. 2D *Trusts* § 221 (1975), which states:

> A constructive trust . . . is a trust by operation of law which arises . . . against one who, by fraud, actual or constructive, . . . by commission of wrong, or by any form of unconscionable conduct, artifice, concealment, or questionable means, or who in any way against equity and good conscience, either has obtained or holds the legal right to property which he ought not, in equity and good conscience, hold and enjoy. It is raised by equity to satisfy the demands of justice.

C. Criticisms of Cy Pres Distribution Mechanisms

Despite the benefits of cy pres distribution mechanisms, they have been criticized on various grounds. These criticisms are examined below.

(1) Windfall

The *Eisen III* court argued that cy pres distribution mechanisms provide a windfall to third parties.[68] The court pointed out that if the price of odd-lot securities on the stock exchange were lowered until illegal profits were disgorged, new traders who entered the market after the price-fixing violations occurred would receive the lower price and, therefore, a windfall.[69] One commentator criticized this reasoning, pointing out that the *Eisen III* court found it better for the class "to receive no compensation than to receive imperfect compensation because benefits to third-party strangers could not be avoided."[70] Clearly, windfall is inevitable in a cy pres distribution of damages or settlement funds. The true question, then, is whether the undesirability of a windfall to third parties is outweighed by the positive effects of cy pres distribution.

Windfalls are hardly taboo in the law. Indeed, the traditional application of the cy pres doctrine to frustrated testamentary intent may result in some windfall to beneficiaries who were not included in the testator's original plan. Examples of accepted remedies that entail windfalls are injunctions,[71] statutory minimum damages,[72] liquidated or treble damages,[73] punitive damages,[74] shareholder derivative suits,[75] suits by wholesalers who have passed on the costs of overcharges,[76] and actions under the Cost of Living Stabilization Act of 1970.[77] The principle common to each of these areas is that some degree of windfall is a tolerable cost of effectuating the deterrent purposes of the applicable laws and ensuring recovery to victims who have actually been injured.

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68. 479 F.2d 1005, 1010 (2d Cir. 1973), *vacated on other grounds*, 417 U.S. 156 (1974). Although the *Eisen III* court referred only to fluid recovery (called "price reduction" in this Note), its criticisms are applicable to all cy pres distribution mechanisms and will be discussed in this broader context.

69. *Id.* at 1010-11.

70. 2 H. NEWBERG, *supra* note 1, § 10.22, at 385. Newberg further notes that "[t]his rationale is defective and is inconsistent with the historic purposes of class action remedies." *Id.*

71. Note, *supra* note 61, at 450.

72. 2 H. NEWBERG, *supra* note 1, § 10.22, at 386.

73. *Id.*

74. *Id.*

75. Note, *The Cy Pres Solution*, *supra* note 3, at 916 (windfall occurs when damages go to current shareholders, some of whom did not own stock at the time of the violation).

76. *Id.*

77. *Id.* at 916, 919 & n.166 (Pub. L. No. 91-379, tit. II, §§ 201-206, 84 Stat. 796 (codified as amended at 12 U.S.C. § 1904 (1980) (authorizing the President to reduce prices "as may be necessary to prevent gross inequities")).

Wholesale prohibition of windfall in class action recoveries would leave a court with three alternatives: fund-sharing among the identifiable claimants, allowing the funds to revert to the defendant, or dismissing the suit. The first option does not solve the problem because it merely shifts the windfall from third parties to class members who submit claims. The other alternatives will allow the defendant to retain its illegally obtained profits and thus constitute windfalls in themselves. Moreover, these alternatives do little to redress the legitimate grievances of class members or to effectuate the purposes of consumer protection laws.[78] As one commentator has pointed out, "it is unclear what policy is served by striking down a remedy which may be the only effective way to vindicate the rights of plaintiff class members, simply because it also benefits third parties."[79]

Thus, in light of the alternatives, the third-party windfalls produced by cy pres distribution mechanisms represent an "incidental but necessary cost" of enforcing laws that protect class members.[80] Furthermore, courts can ensure that the cost truly remains "incidental" by tailoring the distribution to the circumstances of a particular case. One commentator has suggested that the appropriate standard for determining if windfall is acceptable in a particular case is that there be a "reasonable overlap" between the injured class and those benefiting from the cy pres use of the funds.[81] This standard poses no problem if courts and attorneys who contemplate using cy pres distribution mechanisms appreciate the meaning and intent of the cy pres concept: to apply the funds to the next best class, attempting to parallel the intended use of the funds as nearly as possible.

(2) Equitable Power of the Court Under Rule 23

The Second Circuit voiced another concern in *Eisen III*, centering

78. *See* 2 H. NEWBERG, *supra* note 1, § 10.22, at 386; *see also* Note, *The* Cy Pres *Solution*, *supra* note 3, at 902 ("Such unjust enrichment is contended to be both inconsistent with the legislative objective [of antitrust and securities laws] . . . and a limitation upon the class action remedy inconsistent with the equitable origins of class actions.").

79. Note, *supra* note 61, at 450.

80. *Id.* This rationale for allowing third-party recovery also applies to double recovery, in which a plaintiff who has received individual damages also benefits from the cy pres distribution of the remaining funds.

The California appellate court in Bruno v. Superior Court, 127 Cal. App. 3d 120, 179 Cal. Rptr. 342 (1981), found that cy pres damage distribution can exist harmoniously with the policy against third-party recovery embodied in California's antitrust statute, the Cartwright Act, CAL. BUS. & PROF. CODE §§ 16700-16703 (West 1964). The court conceded that damage recovery by an uninjured party is contrary to the Act, but held that the *recovery* of a judgment differs from the *distribution* of funds from that recovery. 127 Cal. App. 3d at 130-31, 179 Cal. Rptr. at 347-48. Thus, third-party benefits resulting from the distribution of legitimately recovered damages would not violate the antitrust statute.

81. 2 H. NEWBERG, *supra* note 1, § 10.22, at 385-86.

on the court's power to authorize a cy pres remedy. While acknowledging the need for consumer protection and sanctions against illegally operated businesses, the *Eisen III* court stated that Federal Rule of Civil Procedure 23 did not authorize it to provide a cy pres remedy.[82]

Rule 23, however, is silent on the issue of remedies or a court's remedial power, and several courts have been undaunted by the constraint which the *Eisen III* court perceived. In *West Virginia v. Chas. Pfizer & Co.*,[83] the federal district court acknowledged that it had the power to adopt cy pres mechanisms and "should exercise its equitable control over these funds for the benefit of all consumers."[84] Similarly, the federal district court in *Bebchick v. Public Utilities Commission*[85] fashioned a cy pres remedy because it was a "judgment appropriate to carry out the opinion."[86]

Federal courts also may rely on Federal Rule of Civil Procedure 54(c) to fashion equitable remedies when plaintiffs are entitled to equitable relief.[87] In *In re Folding Carton Antitrust Litigation*,[88] the federal district court stated that "it is well recognized that the administration of class actions . . . will present novel and unanticipated administrative difficulties. We are admonished to respond with flexibility and imagination. That admonition reflects in part the equitable origin of the class action device, a setting characterized by innovation consistent with settled principles."[89] The California courts, as longtime supporters of cy pres mechanisms, have been more willing than the federal courts to exercise their authority to administer cy pres remedies.[90]

(3) Federal Statutory and Constitutional Challenges

The *Eisen III* court's reluctance to permit cy pres distribution was based in part on concerns over due process and the fundamental legality of the class action procedure invoked on behalf of a fluid class.[91] These concerns implicate the interests of both plaintiffs and defendants, and the

82. 479 F.2d 1005, 1018 (2d Cir. 1972), *vacated on other grounds*, 417 U.S. 156 (1974).

83. 314 F. Supp. 710 (S.D.N.Y. 1970), *aff'd*, 440 F.2d 1079 (2d Cir.), *cert. denied*, 404 U.S. 871 (1971).

84. *Id.* at 728 (quoting with approval "the Alabama Plan" for distribution of funds, proposed by plaintiffs and adopted by defendants).

85. 318 F.2d 187 (D.C. Cir.), *cert. denied*, 373 U.S. 913 (1963).

86. *Id.* at 203.

87. *See* Note, *supra* note 61, at 447 & n.120. Except for a default judgment, "every final judgment shall grant the relief to which the party in whose favor it is rendered is entitled, even if the party has not demanded such relief in his pleadings." FED. R. CIV. P. 54(c).

88. 557 F. Supp. 1091 (N.D. Ill. 1983), *aff'd*, 774 F.2d 1252 (7th Cir. 1984), *cert. dismissed*, 471 U.S. 1113 (1985).

89. *Id.* at 1104 (citations omitted).

90. *See supra* notes 46-55 and accompanying text.

91. 479 F.2d at 1013-18.

resolution of such issues should properly avoid a narrow focus on one group or the other, but should balance all interests to ensure a just result.

In *Eisen*, the trial court admitted that identifying and notifying all class members would be impossible, but asserted that if liability were established it could assess damages based on the average odd-lot differential charged by the defendant. Individual investors who had paid the differential would be allowed to file claims and recover individual judgments, and the court could order that the remaining undistributed funds be applied to reduce odd-lot commissions on future transactions.[92] William Simon offered a summary of the objectionable features of this scheme:

> [M]any of the members of the "fluid class" benefitting from the judgment—the odd-lot purchasers in the late 1970's who made no purchases in the early 1960's—would be people who had not been injured by the alleged violation. Others—those who purchased in both periods and proved claims—would be compensated twice. And many who were in fact damaged during the complaint period would receive nothing.
>
> The effect of [this scheme] is to legislate a shift in private antitrust policy from compensation to confiscation. . . .
>
> Thus, the courts are using a procedural rule to effect changes in substantive law. This is directly contrary to the Enabling Act under which the Rules were promulgated, which provides that rules proscribed [sic] by the Supreme Court for the District Courts "shall not abridge, enlarge or modify any substantive right." . . .
>
> Other serious constitutional questions are raised by the . . . use of separate trials for liability and damages, [which,] either before separate juries or with damages decided by a master, violates defendants' due process rights . . . . *Eisen* . . ., in the interests of expediency, would wholly eliminate defendants' rights to challenge claimants['] proof of damages.[93]

The *Eisen III* court rested its disallowance of the cy pres scheme on very similar grounds; however, such reasoning is distorted because it focuses almost exclusively on defendants' interests, in derogation of the interests

92. The *Eisen III* court stated that

> it was highly improbable that any great number of claims would, for a variety of reasons, ultimately be filed by the 6,000,000 members of the class. No claimant in the 6 years of the progress of the action had shown any interest in Eisen's claim. The average odd-lot differential on each transaction had been $5.18. The average individual class member engaging in five transactions would have paid a total odd-lot differential of $25.90. Assuming a 5% illegal overcharge the recovery is approximately $1.30, and when trebled the average class member would be entitled to damages of $3.90. As the costs of administration might run into the millions of dollars, it was not likely that a rush of claimants would eventuate no matter how extensive the publication.

Id. at 1010.

93. Simon, *Class Actions—Useful Tool or Engine of Destruction*, 55 F.R.D. 375, 385-86 (1973) (footnotes omitted).

of plaintiffs and the purposes which the class action procedure was designed to serve.

a. The Enabling Act Claim

Critics of cy pres distribution such as Simon contend that such mechanisms effect a policy change "from compensation to confiscation." The shift occurs because defendants are required to pay damages not to individual aggrieved plaintiffs but to a large class that probably includes some members who are not actually injured. The critics charge that this policy shift alters substantive rights in violation of the Rules Enabling Act, under which Rule 23 was promulgated.[94]

The rationale of cy pres distribution, however, demonstrates that the underlying policy of substantive law is not changed. The cy pres doctrine will be invoked when direct compensation to identifiable class members is not possible or is impractical, and its object is to compensate the "next best" class that can be ascertained under the circumstances of a particular case. The policy of compensation is undisturbed, and it is better advanced by conferring benefits on the "next best" class than by permitting the defendant to retain profits that it procured in violation of the substantive statutes from which the policy derives.

Moreover, it is questionable whether a remedial device such as cy pres distribution can be considered to affect substantive rights. The distinction between substantive and procedural rules has been most squarely confronted in cases involving conflicts between state and federal rules of procedure after *Erie Railroad v. Tompkins*.[95] The Supreme Court has refused to draw this distinction "by application of any automatic, 'litmus paper' criterion," but has rather looked to the policies underlying the source of the conflict.[96] In this regard, John Hart Ely has suggested that a substantive right is one "granted for one or more nonprocedural reasons, for some purpose or purposes not having to do with the fairness or efficiency of the litigation process."[97] Class actions involving cy pres distribution mechanisms are uniquely concerned with the fairness and efficiency of enforcing the substantive rights of plaintiffs who would otherwise be left without an appropriate remedy and should not be considered to offend the Enabling Act.

b. Due Process Concerns

Defendants' due process objections lie in the aggregation of claims from a fluid class, a practice which has been attacked because it deprives

94. 28 U.S.C. § 2072 (1982).

95. 304 U.S. 64 (1938).

96. Hanna v. Plumer, 380 U.S. 460, 467 (1965). The source of the conflict in *Hanna* was, of course, the choice-of-law rule laid down in *Erie*.

97. Ely, *The Irrepressible Myth of* Erie, 87 HARV. L. REV. 693, 725 (1974).

defendants of their right to contest damages ascertained from individual claims and because "average awards erode due process."[98] That is, defendants should not be compelled to litigate damages allegedly sustained by unidentified class members. However, by focusing exclusively on the interests of defendants, this contention threatens the very purposes which the class action procedure was intended to serve.[99]

Clearly, Rule 23 contemplates that some class actions will go forward even though some members of the class remain unidentified, since it does not uniformly require actual notice to potential plaintiffs but permits "the best notice practicable under the circumstances." The problems that the notice requirement creates for a large plaintiff class are beyond the scope of this Note,[100] but it is sufficient to observe here that the requirement is imposed to protect the due process rights of potential plaintiffs who may be bound by the judgment or subject to liability for counterclaims asserted by the defendant.[101] The defendant's due process interest in the identification of potential class members relates to proof of damages rather than more fundamental concerns of procedural fairness.

As with all problems of proof, the issue of fairness must be determined by considering all the circumstances in a particular case. In the context of consumer class actions, the best possible proof of damages will come from the defendant, whose business records often provide the most reliable source of information concerning its activities.[102] Requiring individuals, whose damages will often be relatively slight, to come forward with their individual claims would frustrate Rule 23's purpose—recognized by the *Eisen II* court—of providing "small claimants with a method of obtaining redress for claims which would otherwise be too small to warrant individual litigation."[103] Thus, a balanced presentation

98. Al Barnett & Son, Inc. v. Outboard Marine Corp., 64 F.R.D. 43, 55 (D. Del. 1974) (cy pres rejected in treble damage antitrust case); *see supra* text accompanying note 93.

99. The *Eisen III* court castigated proponents of cy pres distribution for using "colorful language [that] stimulates the imagination, beguiles one into useful symbolism and opens up the avenues of creative thought . . . [but] almost always [produces] confusion of thought and irrational, emotional and unsound decisions." Yet in setting out its due process concerns, the court relied on its own purple prose, stating that "[i]t is a historical fact that procedural safeguards for the benefit of all litigants constitute some of the most important and salutary protections against oppressions." *Eisen III*, 479 F.2d at 1013.

100. *See generally* J. FRIEDENTHAL, M. KANE & A. MILLER, *supra* note 15, § 16.6, at 749.

101. *Id.*

102. *See, e.g., In re* Sugar Indus. Antitrust Litig., 73 F.R.D. 322, 353 (E.D. Pa. 1976) ("In this litigation, defendants have maintained records and publicly have reported sales according to classes of purchasers. Consequently, it is possible to develop accurate statistical information of total sales to industrial and institutional users, wholesalers and retail grocers seeking class certification.").

103. Eisen v. Carlisle & Jacquelin, 391 F.2d 555, 560 (2d Cir. 1968); *see also* FED. R. CIV. P. 23(b)(3) advisory committee's notes (individual class members' "interests may be theoretical rather than practical: the class may have a high degree of cohesion and prosecution of the

of the due process issue shows that litigating the damages of unidentified class members threatens defendants with very little oppression or unfairness, while foreclosing a fluid class threatens to leave a great many wrongs without a remedy.

Moreover, cy pres distribution of damages, which may confer benefits on individuals who were not actually injured by the defendant's conduct, is subject to no substantial due process challenge from a defendant. If the class action otherwise affords due process throughout the proceedings, the method of damage distribution should not alone be considered to deprive the defendant of its constitutional rights.[104] Furthermore, before a court can order class certification, it must determine that the class members' claims are of a common nature.[105] As Newberg states,

> Just as an adverse decision against the class in the defendant's favor will be binding against the entire class in the aggregate without any rights of individual class members to litigate the common issues individually, so, too, an aggregate monetary liability award for the class will be binding on the defendant without offending due process.[106]

Indeed, the defendant who settles does not have an interest in how the damages are distributed once the settlement terms are finalized,[107] and it also is questionable whether the defendant even has an interest in the distribution of court-determined damages. Under this distinction between "recovery" and "distribution,"[108] due process considerations would be relevant to the recovery of judgment, but not to the distribution process. Outside the context of cy pres distribution, even the Second Circuit, where *Eisen III* was decided, has since approved the aggregation of damages.[109]

In apportioned damages, plaintiffs' due process concerns arise when individual recoveries are not paid and the entire fund is distributed by a

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action through a representative would be quite unobjectionable, or the amounts at stake for individuals may be so small that individual suits would be impractical.").

104. *See* Bruno v. Superior Court, 127 Cal. App. 3d 120, 128-29, 179 Cal. Rptr. 342, 346 (1981).

105. *See, e.g.,* FED. R. CIV. P. 23(a)(2) (requiring "questions of law or fact common to the class").

106. 2 H. NEWBERG, *supra* note 1, § 10.05, at 354-55 (citations omitted).

107. *See In re* Sugar Indus. Antitrust Litig., 73 F.R.D. 322, 353 (E.D. Pa. 1976) ("Upon the establishment of such aggregate damages as may be assessed against defendants, the problem of allocations among classes and distribution within each class largely becomes a plaintiffs' problem, which should not militate against certification of these classes"); Malina, *supra* note 11, at 482 ("[S]ettling defendants have no interest in how the settlement fund is distributed, so long as they are assured that no claims remain outstanding and that they receive the peace they have paid for.").

108. Bruno v. Superior Court, 127 Cal. App. 3d 120, 130-31, 179 Cal. Rptr. 342, 347-48 (1981); *see supra* note 80.

109. Van Gemert v. Boeing Co., 553 F.2d 812, 815 (2d Cir. 1977).

cy pres method.[110] The concern is that plaintiffs who might otherwise have brought individual suits and claimed their damages are now bound by the representative's decision to apply the entire fund to a cy pres distribution mechanism. This argument also applies when the residual funds are used in a cy pres fashion after payment of individual claims, if there are other, unidentified individuals who may have damage claims.[111]

In such cases, however, the procedural difficulties in distributing individual damages must be weighed against the overall benefits of the class action. In all class actions, plaintiffs are given a chance to opt out of the class and pursue their own remedies.[112] By becoming class members, plaintiffs tacitly acquiesce—albeit in advance—in the decisions of the class representative. Furthermore, if the court considers the individual claims to be substantial, it may require payment of individual claims and apply a cy pres mechanism only to residual funds. If individual claims are so insubstantial that a court would approve a cy pres distribution of the entire fund, it is highly unlikely that an individual plaintiff would have brought her own suit. As the dissenting judge in *Eisen III* stated, "[a]ll that the due process clause requires is a procedure that 'fairly insures the protection of the interests of absent parties who are to be bound by [the judgment].' "[113]

When funds remain undistributed in a consumer class action but cy pres distribution mechanisms are disallowed for due process reasons, two unsatisfactory results are possible. First, the suit may not be brought at all because of prohibitive management costs. Second, individual claimants may receive only paltry refunds. The first result could render consumer protection legislation nugatory; the second serves only partially the purposes of disgorgement of unlawful profits and deterrence of future unlawful behavior by the defendant. While the latter results have some value, they are less than adequate, and even more valuable and lasting results can be achieved by using the entire damage or settlement fund for projects in the consumers' interests.

D. Alternatives to Cy Pres

Critics of cy pres distribution mechanisms have suggested a number of alternatives to their use. These alternatives include allowing the undistributed funds to revert to the defendant, reclassifying federal class actions brought for damages as actions for injunctions, and allowing a

110. Note, *Damage Distribution in Class Actions: The Cy Pres Remedy*, 39 U. CHI. L. REV. 448, 464 (1972).

111. *Id.*; *see also* Note, *supra* note 62, at 232-38 (discussing the relevance of due process to notice requirements and adequate representation).

112. *See supra* note 17.

113. Eisen v. Carlisle & Jacquelin, 479 F.2d 1005, 1024 (2d Cir. 1973) (Oakes, J., dissenting) (quoting Hansberry v. Lee, 311 U.S. 32, 42 (1940)), *vacated on other grounds*, 417 U.S. 156 (1974).

congressionally created public body to handle large consumer class actions. Each of these alternatives is discussed below.

(1) Reversion

The first alternative to cy pres distribution is to return undistributed funds to the defendant after all possible claims have been paid. In *Van Gemert v. Boeing Co.*,[114] unclaimed funds reverted to the defendant after the Second Circuit denied a claimant fund-sharing proposal. In *Kestenbaum v. Emerson*, an antifraud suit, the federal district court approved a settlement with a provision that funds remaining after payment of claims and expenses revert to the defendant.[115] Proponents of reversion argue that a failure to return undistributed funds to the defendant effects an "unlawful forfeiture," and that if the funds are not going to be used for direct compensation of the plaintiffs, they should revert to the defendant.[116]

This "unlawful forfeiture," however, can be viewed merely as a disgorgement of illegally obtained profits, which prevents unjust enrichment and serves the important function of deterrence.[117] In *SEC v. Golconda Mining Co.*,[118] a securities fraud case, the federal district court stated that "[t]o permit the return of the unclaimed funds, a portion of the illicit profits, would impair the full impact of the deterrent force that is essential if adequate enforcement of the securities acts is to be achieved" and that the "circumstance that some of the claimants cannot presently be found does not justify turning back to [defendants] their ill- gotten profits."[119] The California Supreme Court has pointed out that, without cy pres distribution mechanisms, "defendants may be permitted to retain ill-gotten gains simply because their conduct harmed large numbers of people in small amounts instead of small numbers of people in large

114. 553 F.2d 812, 815-16 (2d Cir. 1977) (class of nonconverting debenture holders brought suit claiming insufficient notice for exercising conversion rights).

115. [1981-1982 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 98,293 (S.D.N.Y. 1981). A settlement might not include admission of wrongdoing by the defendant. The terms of the settlement should determine the fate of unclaimed funds, however, and it is in the class members' best interest that excess funds be used on their behalf rather than revert to the defendant.

116. *See* 2 H. NEWBERG, *supra* note 1, § 10.24, at 390. Newberg disagrees, however, relying upon the importance of deterrence.

117. *Id.* The court in *In re Folding Carton Antitrust Litigation* rejected the defendant's equitable claim to the reserve fund "in light of the Sherman Act policy of deterrence and the defendants' wrongdoing." 557 F. Supp. 1091, 1105 (N.D. Ill. 1983), *aff'd*, 744 F.2d 1252 (7th Cir. 1984), *cert. dismissed*, 471 U.S. 1113 (1985); *see also* Kohn & Kaplan, *supra* note 26, at 297 n.17 ("Division among the other claimants, . . . the 'floating class', and escheat, are three obvious alternatives, each of which is in conformity with the law, and certainly morally preferable to leaving the malefactor with his ill-gotten gain.").

118. 327 F. Supp. 257 (S.D.N.Y. 1971).

119. *Id.* at 259 (footnotes omitted).

amounts."[120] Clearly, allowing undistributed funds to revert to the defendant confers far fewer benefits than a scheme designed to compensate, albeit indirectly, a "next best" class of consumers.

(2) Reclassification of Suits to Provide Injunctions

A second alternative to cy pres, mentioned by the *Eisen III* court, is to avoid the problem of residual damages altogether by allowing courts to reclassify Rule 23(b)(3) suits for damages as Rule 23(b)(2) suits for injunctions.[121] The court reasoned that awards of attorney's fees would remain as incentives to bringing class actions. However, when unlawful gains remain in the defendant's hands, an injunction is simply inadequate.[122] Neither the policy of disgorgement nor that of compensation is advanced by this plan.

(3) Congressional Action

A third suggestion for avoiding the problem of undistributed funds in consumer class actions, also noted in *Eisen III*, is for Congress to create a "public body to do justice in the matter of consumers' claims in such fashion as to afford compensation to the injured consumer," thereby allowing Congress to decide how the money is spent.[123] In 1981, the Department of Justice made a proposal to Congress to repeal Federal Rule of Civil Procedure 23(b)(3) and replace it with a provision for "class compensatory actions" and "public actions."[124] These controversial proposals have not gathered substantial congressional support. Even if an agency eventually is established, it seems inappropriate to require taxpayers, rather than the defendant whose conduct is in question, to fund the administrative costs.[125]

120. State v. Levi Strauss & Co., 41 Cal. 3d 460, 472, 715 P.2d 564, 571, 224 Cal. Rptr. 605, 612 (1986).

121. *Eisen III*, 479 F.2d 1005, 1019-20 (2d Cir. 1973), *vacated on other grounds*, 417 U.S. 156 (1974).

122. Injunctions may be appropriate in circumstances similar to those in Blue Chip Stamps v. Superior Court, 18 Cal. 3d 381, 556 P.2d 755, 134 Cal. Rptr. 393 (1976) (small sales tax overcharges already in state treasury and defendant held no unlawful gains).

123. *Eisen III*, 479 F.2d at 1019.

124. H.R. 13, 97th Cong., 1st Sess., 127 CONG. REC. 125 (daily ed. Jan. 5, 1981). The proposal provided that undistributed funds in public action cases could escheat to the government to finance other public actions and enforcement of the new statute. The proposal was widely debated and returned to the Department of Justice for redrafting. For discussion of this proposal, see Mickum & Rhees, *Federal Class Action Reform: A Response to the Proposed Legislation*, 79 KY. L.J. 799 (1981).

Congress has, however, authorized the use of cy pres mechanisms for residual funds in the context of *parens patriae* actions, in which a state brings suit on behalf of its citizens. 15 U.S.C. §§ 15c-15e (1982).

125. Although the agency eventually could become self-supporting, it is likely that tax dollars would be spent at its inception.

The dissenting judge in *Eisen III* criticized the "public body" suggestion, calling it "an abdication of judicial responsibility."[126] The dissent further stated that "[i]t is as much to say that the courts are insufficiently inventive to be capable of handling a matter—the distribution of unlawfully obtained money to a large number of people. I doubt this very much. I suspect that the courts can do the job."[127]

None of these suggested methods of avoiding undistributed funds adequately satisfies the goals of compensation of consumers, disgorgement of illegally obtained profits, and deterrence of future misconduct. Only a method that addresses all of these concerns will be truly effective in the consumer class action context.

E. The Cy Pres Distribution Mechanisms

The literature on the cy pres doctrine in the context of class actions recognizes four types of cy pres distribution mechanisms. The first three options—escheat to the government, price reduction, and claimant fund-sharing—are discussed in this subsection. The fourth option, the consumer trust fund, is considered in the following subsection.

(1) Governmental Escheat

One method of distributing settlement and aggregate damage funds is to allow the funds to escheat to the state.[128] There are two forms of governmental escheat. The court may direct that the funds be used for a specific purpose ("earmarked" escheat) so that it benefits a group of persons who approximate the injured class.[129] Alternatively, the money may escheat unconditionally, to be deposited into the state treasury and used at the government's discretion.[130]

An advantage of the earmarked escheat mechanism is that it minimizes distribution costs because the government has agencies in place that are organized to manage programs beneficial to the public at large. By disposing of the entire settlement fund or damages, earmarked escheat also realizes the goals of disgorgement of illegal profits and deter-

126. 479 F.2d at 1024 (Oakes, J., dissenting).

127. *Id.* at 1024-25.

128. Depending upon the state's escheat statute, such a disposition may be mandatory. California recently revised its escheat statute to allow courts to make alternative dispositions of unclaimed funds. CAL. CIV. PROC. CODE § 1519.5 (West 1982) ("[I]t is the intent of the Legislature that nothing in this section shall be construed to change the authority of a court or administrative agency to order equitable remedies.").

129. *E.g.*, West Virginia v. Chas. Pfizer & Co., 314 F. Supp. 710 (S.D.N.Y. 1970) (portion of settlement funds set aside for public health programs), *aff'd*, 440 F.2d 1079 (2d Cir.), *cert. denied*, 404 U.S. 871 (1971).

130. The unclaimed-property law of a state would effectuate this result. For discussion of unconditional escheat, see Note, *Collecting Overcharges*, *supra* note 3, at 1056-57; Note, *supra* note 110, at 455-56; *Developments in the Law*, *supra* note 62, at 1523, 1527.

rence of future illegal activities.[131] For example, in *West Virginia v. Chas. Pfizer & Co.*,[132] the court used earmarked escheat to allocate residual funds of a $100 million settlement entered into by a number of antibiotics manufacturers. The settlement fund was given to state governments to be used for "public health purposes" and eventually financed various projects, including treating drug addiction, instituting pollution control programs, and informing the public of environmental pollution laws.[133]

The danger of earmarked escheat is that nothing prevents the government from diverting the earmarked funds away from the intended purpose.[134] Similarly, if the funds are turned over to supplement an existing service, the government can simply reduce existing budget allocations proportionately rather than augment the original funding.[135] Thus, although earmarked escheat serves the major purpose of keeping the funds from reverting to the defendant, safeguards are needed to ensure

131. State v. Levi Strauss & Co., 41 Cal. 3d 460, 474, 715 P.2d 564, 572, 224 Cal. Rptr. 605, 613 (1986). This is also a feature of the existing-organization type consumer trust fund. For discussion, see *infra* notes 180-82 and accompanying text. *See also* 2 H. NEWBERG, *supra* note 1, § 10.19, at 381; Note, *supra* note 110, at 455-56; Note, *An Economic Analysis*, *supra* note 3, at 180; *Developments in the Law*, *supra* note 62, at 1527.

132. 314 F. Supp. 710 (S.D.N.Y. 1970), *aff'd*, 440 F.2d 1079 (2d Cir.), *cert. denied*, 404 U.S. 871 (1971).

133. *Id.* at 728; *see* Report of Special Master Kissam on Claims of Institutions and the Excess Consumer Fund at 11, Texas v. Chas. Pfizer & Co., 68 Civ. 4375 M 19-93 (S.D.N.Y. filed Aug. 24, 1973) (Texas' settlement fund divided among state health and education agencies and state attorney general for educating public on pollution laws).

134. *See* Note, *An Economic Analysis*, *supra* note 3, at 180 ("[T]he advantages of earmarking the damage award are illusory. Nothing prevents the government from lowering its expenditures on the designated project by the amount of the damage award and reallocating the extra funds to other governmental projects."); *see also* Note, *Collecting Overcharges*, *supra* note 3, at 1049 ("[T]his money might serve only to replace existing budgets for energy purposes . . . ."); Note, *supra* note 110, at 458 ("Except for insuring that the desired programs were initiated, a cy pres solution allowing diversion of formerly budgeted funds would serve the same general purpose as an unrestricted escheat to the state.").

135. *See generally* Note, *supra* note 110, at 458 & n.42; *see also* Note, *Collecting Overcharges*, *supra* note 3, at 1056-57.

As an illustration, overcharges collected from major oil refiners that violated pricing and allocation regulations were promised by President Carter to be used for low-income energy needs. *See id.* at 1039-40. The Reagan Administration requested that the states turn over their allocations of the overcharge fund to the federal government to reduce the federal budget deficit. Although it can be argued that all Americans will benefit from a reduced federal budget deficit, this application of the funds is a far cry from an attempt to address energy needs of low-income consumers. According to a telephone conversation with the California Department of Finance, Governor Deukmejian of California was the only state governor to support this plan, which was ultimately rejected by Congress. *But see* State v. Levi Strauss & Co., 41 Cal. 3d 460, 474 n.10, 715 P.2d 564, 572 n.10, 224 Cal. Rptr. 605, 613 n.10 (1986) ("[E]armarked escheats can be conditioned on the state's promise not to divert previously budgeted funds. Though the court's ability to enforce such conditions may be limited, there is no reason to assume that the state would act in bad faith.") (citation omitted).

that this technique will satisfy cy pres notions of damage distribution. The lack of control over governmental use of damages or settlement funds threatens its effectiveness.

When funds escheat unconditionally to the state, the benefit to consumers is so dispersed that it is likely to go unnoticed. While unconditional escheat serves the goals of disgorgement of illegal profits and deterrence of wrongdoing, compensation of injured class members is both remote and diffuse. In some instances, however, it may be more efficient for the state to retain unlawful funds already in its possession, rather than to allow a class action suit that seeks to compensate individual plaintiffs directly. In *Blue Chip Stamps v. Superior Court*,[136] for example, unlawfully assessed sales taxes were already in the state treasury. The California Supreme Court determined that the expense and burden of going forward with a class action outweighed the benefits of direct recovery to the class and simply left the money with the government. However, despite the ease of administration, the California Supreme Court considers unconditional escheat to be the "least focused compensation" to class members, to be regarded as a "last resort . . . where a more precise remedy cannot be found."[137]

(2) Price Reduction

A second application of the cy pres doctrine to the problem of undistributed class action funds is the price reduction mechanism.[138] Under this approach, the price of a product or service is lowered until the defendant has disgorged all illegally gained profits. This solution is useful because the benefits of lower prices are bestowed on a similar, although "fluid" class of plaintiffs.

Several courts have successfully applied the price reduction mecha-

136. 18 Cal. 3d 381, 556 P.2d 755, 134 Cal. Rptr. 393 (1976). In *Blue Chip Stamps*, the court dismissed a class action in which the plaintiffs had alleged that excessive sales taxes had been collected by a trading stamp company. The court rejected individual recovery on the facts of the case, in part because the amount of individual damages was small and the overcharges had been paid to the state treasury, benefiting state residents in general. *Id.* at 386-87, 556 P.2d at 758-59, 134 Cal. Rptr. at 396-97.

137. State v. Levi Strauss & Co., 41 Cal. 3d 460, 475, 715 P.2d 564, 572-73, 224 Cal. Rptr. 605, 613-14 (1986).

138. *See* Bebchick v. Public Utils. Comm'n, 318 F.2d 187, 203-04 (D.C. Cir.) (per curiam) (revenues from improperly granted rate increase used to keep fares down on behalf of current transit riders), *cert. denied*, 373 U.S. 913 (1963). The *Eisen III* court declared this application of cy pres distribution "illegal, inadmissible as a solution of the manageability problems of class actions and wholly improper." 479 F.2d at 1018.

In his concurrence to *Levi Strauss*, Justice Grodin noted that price reduction is not actually a method of residue distribution, but an alternative to the creation of a residue. 41 Cal. 3d 460, 488 n.1, 715 P.2d 564, 582 n.1, 224 Cal. Rptr. 605, 623 n.1 (1986) (Grodin, J., concurring). Although Justice Grodin is correct, price reduction is commonly discussed in the context of cy pres distribution mechanisms.

nism. In the California case of *Daar v. Yellow Cab Co.*,[139] settlement funds were used to lower taxicab meter rates to disgorge the cab company's unlawful overcharges.[140] Similarly, the settlement of a federal district court case, *Colson v. Hilton Hotels Corp.*, provided for hotel room rate reduction of fifty cents per day until the settlement funds were depleted.[141] Without acknowledging the concept of cy pres or price reduction, a federal district court, in the non-class action case of *Oakland Raiders v. Office of Emergency Preparedness*,[142] required that football ticket overcharges be refunded to identifiable purchasers and that the remaining funds be disgorged by reducing the price of future tickets.

Despite the laudable intention behind this cy pres mechanism, which is to reach as many uncompensated class members as possible, the price reduction system of disgorging illegal profits presents several problems. Uninjured plaintiffs who benefit from the price reduction receive windfalls, and injured plaintiffs who already have received their share of the damage fund may enjoy double recovery if they also benefit from the price reduction.[143] Some courts have rejected price reduction after determining that too large a discrepancy between the class benefited and the class harmed would result.[144]

At least one commentator has objected to price reduction on economic grounds.[145] Under this theory, if the price of the goods or services is reduced, consumers will incur inconvenience costs in seeking the lower price. Consumers who must expend more time and energy to acquire the item (for example, by making a longer trip to a store that carries the discounted item, and perhaps waiting in line to purchase it) ultimately may benefit little from the reduced price.[146] Furthermore, the defendant's competitors may be affected adversely by the price decrease, partic-

139. 67 Cal. 2d 695, 433 P.2d 732, 63 Cal. Rptr. 724 (1967).

140. The settlement is not discussed in the court's opinion. For a description of the settlement, see Berk, *supra* note 6, at 651 n.5; Comment, *supra* note 3, at 366 n.186.

141. 59 F.R.D. 324, 327 (N.D. Ill. 1972).

142. 380 F. Supp. 187, 190 (N.D. Cal. 1974).

143. In the *Daar* settlement, for example, some customers were reimbursed individually based on the defendant's records. By additionally taking advantage of the reduced fares, these customers could potentially recover more than their share. *See supra* text accompanying note 93.

144. *See, e.g.*, City of Philadelphia v. American Oil Co., 53 F.R.D. 45, 72 (D.N.J. 1971) (court ruled that the class to be benefited was sufficiently distinct from the injured class that price reduction was inappropriate).

The overlap of injured and benefited consumers depends in part on the class of consumers and the frequency with which they purchase the product or service. For example, purchasers of "big ticket" items, such as automobiles or expensive household appliances, would be less likely to benefit from a price reduction than users of a product or service purchased more frequently. *See* Brief for Amici Curiae at 23-24, State v. Levi Strauss & Co., 42 Cal. 3d 460, 715 P.2d 564, 224 Cal. Rptr. 605 (1986) (No. AO15639) [hereinafter Brief for Amici Curiae].

145. Note, *An Economic Analysis*, *supra* note 3, at 173.

146. *Id.* at 187.

ularly if it forces them to lower their prices to compete with the defendant's product or services.[147]

It is also possible that an enterprising individual could purchase the discounted goods and resell them at a higher rate, thus defeating the intention to benefit consumers.[148] The defendant also could reduce quality or production levels to avoid incurring a loss of revenue, or the price reduction could be so small that it would go unnoticed and not truly benefit consumers.[149] Further, if the price of the product or service is fixed by independent retailers rather than the defendant itself, monumental management problems arise in ensuring that the price reduction is passed on to the consumer.[150] In light of these objections, monopolies, because they have no competitors, may be the only businesses in which the price reduction mechanism can benefit consumers without harming the market.[151] Thus, the price reduction mechanism is of limited utility in distributing settlement funds and damages to the next best class in consumer class actions.

(3) Claimant Fund-Sharing

A third cy pres distribution mechanism is claimant fund-sharing, which allows class members who submit claims to divide the entire settlement or damage fund pro rata.[152] Claimant fund-sharing leaves no residue because the entire fund is distributed to claimants after deducting expenses and attorney's fees. While this mechanism compensates all claimants who submit legitimate claims, the inherent difficulties are readily apparent. Class members who file claims will probably receive a windfall since it is highly unlikely that all class members will come forward.[153] On the other hand, administrative costs may consume such a large portion of the fund that individual recoveries are miniscule despite

147. *Id.* at 195.

148. Note, *supra* note 110, at 462.

149. Brief for Amici Curiae, *supra* note 144, at 23-24.

150. State v. Levi Strauss & Co., 41 Cal. 3d 460, 474, 715 P.2d 564, 572, 224 Cal. Rptr. 605, 613 (1986).

151. Note, *An Economic Analysis*, *supra* note 3, at 194-95. The author also suggests that the price reduction method, even when employed by a monopoly, will be effective only under certain circumstances. *Id.* at 195.

152. Justice Grodin's observation that price reduction is not a distribution mechanism for residual funds, *see supra* note 138, also applies to claimant fund-sharing. In both cases, the mechanisms avoid the creation of a residual fund rather than disposing of one.

153. *See* Bruno v. Superior Court, 127 Cal. App. 3d 120, 123, 79 Cal. Rptr. 342, 343 (1981) ("[I]t is likely that only a fraction of the class members will have the desire, and documentation, to file an individual claim for part of the damages."). *But see* A CLASS ACTION SUIT THAT WORKED, *supra* note 2, at xvi, in which the authors contend that, contrary to popular belief, informed consumers "will step forward and participate in large numbers."

Newberg reports that when claimant fund-sharing distribution of a common fund has been used in antitrust and consumer cases, the percentage of total class members who file claims has ranged from .28% to 48.13%. Appendix 8-4, Tables of Response Rate Levels,

the pro rata distribution among claimants. Furthermore, it would be to the class representative's advantage to discourage claims by class members, thus providing a disincentive to adequate representation.[154] This mechanism also deprives unidentified class members of any direct benefit from the class recovery. It is thus most appropriate for a class in which a large proportion of class members participate and submit accurate claims.[155]

The California Supreme Court, under unusual circumstances, reluctantly approved the claimant fund-sharing mechanism in *State v. Levi Strauss & Co.*[156] This case demonstrated some of the difficulties of a large consumer class action. The State of California brought suit as *parens patriae*[157] and a class action under the Cartwright Act, California's antitrust statute.[158] Defendant Levi Strauss & Co., which already had been charged with retail price fixing by the Federal Trade Commission,[159] entered into a settlement agreement with the California Attorney General calling for a claimant fund-sharing distribution scheme. The trial court ordered that, in addition to an extensive media campaign to alert consumers to the proposed settlement, notice of the settlement be sent to every household in California, allowing each to submit a claim. Although the claim form stated that claimants might receive up to $2.00 per pair of jeans purchased at the inflated price,[160] the estimated recovery amount per pair of jeans was only thirty-five to forty cents.[161] Thus, almost $2 million of the settlement fund went toward notifying class

Table I: Response Rates When Common Fund Distributed Pro Rata Among Those Filing Proofs of Claim, 2 H. NEWBERG, *supra* note 1, at 206-10, 213.

When the claimants have been paid only their shares, resulting in the creation of residual funds, the percentage of claimants has ranged from .0006% to 10.47%. *See* Appendix 8-4, Tables of Response Rate Levels, Table II: Response Rate When Common Fund Distributed Only to Pay Individual Claims of Those Filing Proofs of Claim, and Which Yields Unclaimed Funds, *id.* at 214-15.

For a discussion of the windfall problem, see *supra* notes 68-81 and accompanying text.

154. Note, *supra* note 110, at 453.

155. State v. Levi Strauss & Co., 41 Cal. 3d 460, 476, 715 P.2d 564, 573, 224 Cal. Rptr. 605, 614 (1986).

Claimant fund-sharing was employed in Barr v. WUI/TAS, Inc., 1976-1 Trade Cas. (CCH) ¶ 60,725 (S.D.N.Y. 1976), in which the federal district court approved a settlement requiring a telephone answering service, which had allegedly fixed prices, to distribute an equal amount to each class member.

156. 41 Cal. 3d 460, 715 P.2d 564, 224 Cal. Rptr. 605 (1986).

157. State attorneys general have *parens patriae* authority to bring actions on behalf of state residents for various offenses and to recover on their behalf. *Parens patriae* is a "concept of standing used to protect . . . quasi-sovereign interests such as health, comfort, and welfare of the people." BLACK'S LAW DICTIONARY 1003 (5th ed. 1979).

158. CAL. BUS. & PROF. CODE §§ 16700-16703 (West 1964).

159. Petition for Hearing at 8, *Levi Strauss*, 41 Cal. 3d 460, 715 P.2d 564, 224 Cal. Rptr. 605 (No. SF24699) [hereinafter Petition for Hearing].

160. *Levi Strauss*, 41 Cal. 3d at 467 n.4, 715 P.2d at 569 n.4, 224 Cal. Rptr. at 610 n.4.

161. *Id.* at 464, 715 P.2d at 565, 224 Cal. Rptr. at 606.

members of their opportunity to claim some thirty cents per pair of jeans.[162]

Other practical problems with the settlement's fund-sharing scheme had become apparent by the time the case reached the supreme court. The intervenor calculated that only 20-40% of the class would receive any type of compensation, since "individual recoveries were so small that only a minority of class members bothered to file claims."[163] The court also questioned the veracity of the claims submitted; of the audited claimants (the top 5% of those who claimed the largest purchases), fewer than 20% responded when asked to resubmit their claims with a sworn statement. The court stated that "[t]he magnitude of this negative response casts doubt on the accuracy of claims beyond the top 5 percent as well."[164]

The intervenor and amici curiae in the *Levi Strauss* appeal suggested that claimant fund-sharing is used effectively only when the recovery is large enough that class members will come forward to make claims;[165] indeed, amici emphatically contended that claimant fund-sharing "should never be used in consumer class actions involving trivial damages."[166] However, neither the intervenor nor amici were willing to defeat the expectations of the over one million households that had responded to the mass mailings and the media campaign, and this concession left the court no practical alternative but to uphold the fund-

162. Brief for Amici Curiae, *supra* note 144, at 41.

163. *Levi Strauss*, 41 Cal. 3d at 476, 715 P.2d at 573, 224 Cal. Rptr. at 614.

164. *Id.* at 476-77, 715 P.2d at 574, 224 Cal. Rptr. at 615. With regard to the veracity of claims, it is interesting to note that researchers who followed up on claims in the antibiotics antitrust litigation, *see supra* notes 132-33 and accompanying text, found "a very high degree of consumer faith in the accuracy and honesty of their claims, and a consequent willingness to permit those claims to be subject to independent verification" in the group of claimants requesting up to $150 in refunds. A CLASS ACTION SUIT THAT WORKED, *supra* note 2, at 30. Those claiming more than $150 were given three options: they could 1) submit documentation to support their claims and have their signatures notarized; 2) describe the illnesses for which the antibiotics were used, identifying the doctors and hospitals involved, and have their signatures notarized; or 3) authorize the court to determine the amount of their refund. *Id.* at 35. A mere 4% of claimants chose the first option; 8% chose the second option, and the majority, 54%, chose the third option and allowed the court to determine the amount of their refunds. 33% of the claimants did not respond. *Id.* at 41. Given that only 12% of class members claiming large refunds were willing to produce some documentation and have their signatures notarized, it is possible to question the validity of the claims, although several other factors could explain, at least in part, the low response rate. One of the problems with consumer class actions is that class members rarely keep receipts to document their purchases. Further, a mail request for documentation can encounter several obstacles, including recipients who forget to resubmit the claim, those who mistake the letter for "junk mail," and those who are too busy to pursue the matter further.

165. Brief for Amici Curiae, *supra* note 144, at 28. The amici included the Consumers Union, the Consumer Federation of California, California Rural Legal Assistance, and Ralph Nader. *Id.*

166. *Id.* at 33.

sharing settlement.[167]

Thus, the court's approval of claimant fund-sharing as a settlement distribution scheme in *Levi Strauss* should probably be limited to its facts. The scheme did not eliminate the distributional problems engendered by the class action, since many of the original claimants had moved or were otherwise difficult to locate, and substantial interest had accrued on the settlement fund.[168] In offering the trial court guidance for distribution of the residue on remand, the court gave little support to the fund-sharing approach. While conceding the primary benefit of claimant fund-sharing—that the entire class recovery is disbursed so that no residual funds remain—the court noted the disadvantages of windfall to claimants and the lack of benefits to class members who do not submit claims. The court stated that, for claimant fund-sharing to be advantageous, a large proportion of class members would have to participate and submit accurate claims.[169]

The *Levi Strauss* court was also unconvinced that the claimant fund-sharing plan would provide sufficient "overlap" between the injured class and those benefited to justify use of claimant fund-sharing.[170] In her concurrence, Chief Justice Bird stated that "[s]uch a plan can scarcely be considered reasonable as the sole means of distributing a class fund if the overwhelming majority of class members recover nothing."[171] Justice Lucas, dissenting from the majority's endorsement of the consumer trust fund concept, quoted with approval the trial court's finding that "there is no basis for concluding that the proposed plan of distribution discriminates against any class members."[172] However, it is difficult to understand this point of view when, under the proposed claimant fund-sharing, 60-80% of the class may not have received any benefits.

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167. Nearly $1.5 million of the settlement fund has already been spent on the present distribution plan. Intervener criticizes this expenditure, but does not contend that reversal would somehow restore the funds. Further, over 1 million household claims have been received and processed, thereby inducing legitimate expectations of compensation among class members. Intervener remains critical of this method of distribution to individual consumers on the basis of largely unverified claims. Nonetheless, at oral argument, intervener joined amici . . . in urging that—with some additional security precautions—these claims be honored. However, this court can preserve the present claims only by upholding the settlement. . . .

In a sense, this court is confronted with a fait accompli. The only effective means to prevent further expenditures of class funds and to vindicate the claimants' current expectations—ends desired by all the parties—is to affirm the settlement.

Levi Strauss, 41 Cal. 3d at 470-71, 715 P.2d at 569-70, 224 Cal. Rptr. at 610-11 (citations omitted).

168. *Id.* at 471, 479, 715 P.2d at 570, 575-76, 224 Cal. Rptr. at 611, 616-17.

169. *Id.* at 476, 715 P.2d at 573, 224 Cal. Rptr. at 614.

170. *Id.* at 479, 715 P.2d at 574, 224 Cal. Rptr. at 616.

171. *Id.* at 483, 715 P.2d at 578, 224 Cal. Rptr. at 619 (Bird, C.J., concurring).

172. *Id.* at 489-90, 715 P.2d at 583, 224 Cal. Rptr. at 624 (Lucas, J., concurring & dissenting).

Thus, claimant fund-sharing not only bars nonclaiming class member from any recovery for their injuries, it also presents a significant windfall problem and substantial administrative costs without ensuring that the total recovery is actually distributed. As the *Levi Strauss* court suggested, the consumer trust fund addresses these concerns.[173]

III. The Consumer Trust Fund

The consumer trust fund, the fourth type of cy pres distribution mechanism, is established by depositing undistributed settlement funds or damages with a "trustee."[174] In *State v. Levi Strauss & Co.*,[175] the California Supreme Court in dicta approved the intervenors' proposal for a consumer trust fund as "entirely consistent" with the court's affirmance of the terms of the settlement between the Attorney General and Levi Strauss & Co., and noted that the proposal had "considerable merit."[176] The consumer trust fund can be arranged in at least two ways.

A. The Foundation Method

The first method resembles a foundation that solicits grant proposals and then funds projects most in accordance with its goals. Accordingly, under the foundation method of managing a consumer trust fund, the trustees finance projects beneficial to the injured consumer class and those similarly situated.

The Consumer Energy Council of America (CECA) proposed the foundation method for managing funds collected from oil companies that

173. The petitioners proposed the establishment of a nonprofit corporation to administer a trust fund established from the residue of the fund-sharing scheme. A board of directors would be comprised of nine members: five appointed by the Governor and four appointed by the Attorney General. Petitioners envisioned this corporation as an ongoing venture to receive undistributed funds from future class actions as well. *Id.* at 466, 715 P.2d at 567, 224 Cal. Rptr. at 608.

174. The idea of using a trustee dates back at least as far as *Daar v. Yellow Cab*, in which the State of California, as amicus curiae, suggested depositing the cab fare overcharges with the court or a trustee. It appears that the state's primary goal was to remove the unlawful overcharges from the defendant's hands. 67 Cal. 2d 695, 715 n.15, 433 P.2d 732, 746 n.15, 63 Cal. Rptr. 724, 738 n.15 (1967).

175. 41 Cal. 3d 460, 715 P.2d 564, 224 Cal. Rptr. 605 (1986).

176. *Id.* at 471, 479, 715 P.2d at 570, 576, 224 Cal. Rptr. at 611, 617. Although the court left the distribution of residual funds to the trial court's discretion, it noted that the trial courts should have "the full range of alternatives at their disposal." *Id.* at 479, 715 P.2d at 576, 224 Cal. Rptr. at 617. The court listed four criteria to consider in choosing the appropriate cy pres distribution mechanism:

1) the amount of compensation provided to class members;
2) the proportion of class members sharing in the recovery;
3) the size and effect of the spillover to nonclass members;
4) the costs of administration.

Id.

illegally overpriced gasoline, heating oil, and other petroleum products in the 1970s.[177] CECA suggested forming a board of trustees comprised of representatives from state and local governments as well as established consumer groups. The trustees would fund local energy projects and study other means of using the funds for the benefit of consumers. CECA perceived the board of trustees as a safeguard against the hazards of disbursing the money directly to the Department of Energy, where its use would be uncertain.[178]

A 1981 settlement involving the New York Public Service Commission provides another example of the foundation method of the consumer trust fund. In that case, the defendant utility companies agreed to provide $12 million to fund an independent research program that would study the Hudson River ecosystem, thereby creating the Hudson River Foundation for Science and Environmental Research.[179]

B. The Existing-Organization Method

The second method of establishing a consumer trust fund is to provide funding to an existing organization to support new and ongoing projects on behalf of consumers. Like earmarked escheat,[180] the plan takes advantage of existing programs, thereby minimizing startup costs and delays.[181] Instead of simply leaving money in the hands of the government, however, the existing-organization method ensures a benefit to consumers because of the organization's fiduciary duty to consumers and the court's ability to intervene if it appears that funds are being used inappropriately.[182]

One case in which a court successfully awarded a consumer trust fund to an existing organization is *Vasquez v. Avco Financial Services*.[183] In *Vasquez*, a California superior court found that defendant Avco Financial Services of Southern California violated section 1807.2 of Califor-

177. *See* Note, *Collecting Overcharges*, *supra* note 3, at 1057-58.

178. Such concerns were realistic in light of President's Reagan's later attempt to use these funds to lower the federal budget deficit. *See supra* note 135. As of this writing, the final disposition of these funds has not yet been determined.

179. Described in Brief for Amici Curiae, *supra* note 144, at 39.

180. *See supra* notes 131-35 and accompanying text.

181. The California Supreme Court noted the cost-saving advantage of allocating funds to an existing organization, but warned against possible conflicts of interest, in which an organization would use funds for "pet" projects. *Levi Strauss*, 41 Cal. 3d at 475, 715 P.2d at 573, 224 Cal. Rptr. at 614. The court suggested that when such conflicts are identified, earmarked escheat or foundation-type consumer trust funds may be appropriate. *Id.* at 475 n.11, 715 P.2d at 573 n.11, 224 Cal. Rptr. at 614 n.11. However, accountability procedures can eliminate conflict-of-interest problems in the trust fund. *See infra* notes 182 & 190 and accompanying text.

182. Note, *An Economic Analysis*, *supra* note 3, at 179 & n.21.

183. No. NCC 11933 B (Los Angeles Super. Ct. Apr. 24, 1984).

nia's Unruh Act[184] by "flipping" consumer retail installment contracts into new loans with substantially higher interest rates. By flipping the contracts into new loans, Avco circumvented the consumer protection statute's 18% ceiling on finance charges for installment contracts.[185] A consumer brought a class action suit and the State Department of Consumer Affairs entered the case as an intervenor.

The trial court granted the plaintiffs' and intervenor's request that unclaimed damages be distributed as a consumer trust fund. Avco paid $1.4 million of the residual settlement funds to Consumers Union of United States, Inc., West Coast Regional Office (Consumers Union), to "be used in California for a purpose that is reasonably designed to benefit those persons who would otherwise have received the refund."[186] Consumers Union was selected in part because of its reputation for vigorously pursuing lawsuits and activities to protect the interests of consumers.[187]

The agreement among Consumers Union, the plaintiffs' attorney, and the Department of Consumer Affairs provided that funds held by Consumers Union would be used to reimburse Avco for any late claims presented by class members; the remainder would be used for administrative, legislative, legal, research, educational, and direct service projects to benefit those persons who would otherwise have received the refund. Consumers Union is to review the "problems and needs of low- and moderate-income people in California in connection with consumer credit transactions, consumer financial issues, and other related matters."[188] To date, the trust fund has helped Consumers Union finance several lawsuits against financial institutions, involving charges such as fraudulent interest-rate advertising and discrimination by banks against consumers.[189]

To comply with the settlement provisions, Consumers Union has

184. CAL. CIV. CODE §§ 1801-1812.20 (West 1985). The Unruh Act regulates the consumer credit industry.

185. Los Angeles Times, Feb. 3, 1981, § 2, at 1, col. 4.

186. San Francisco Examiner, Feb. 6, 1986, at D3, col. 4. The residual fund existed because some class members could not be located and some accounts predated Avco's conversion to a computerized accounting system. Application for Approval of Amended Memorandum of Understanding with Consumers Union at 2, 4, *Vasquez*, No. NCC 11933 B [hereinafter Memo of Understanding].

187. Memo of Understanding, *supra* note 186, at 4. Consumers Union is a nonprofit membership organization chartered in 1936 to provide information, education, and counsel about consumer goods and services and the management of family income. Consumers Union publishes *Consumer Reports,* a monthly magazine with a paid circulation of 3.2 million, which regularly carries articles rating products that Consumers Union has tested, as well as articles on consumer services, marketplace economics, and judicial actions that affect consumer welfare. Over 300,000 residents of California subscribe to *Consumer Reports. Id.*

188. *Id.* Uses of the funds are not limited to those enumerated.

189. San Francisco Examiner, Feb. 6, 1986, at D3, col. 4.

engaged an advisory board that meets regularly to review existing projects and make recommendations for future expenditures. Board members receive a small honorarium per meeting, payable from the fund, making this an inexpensive method of providing additional expertise for funding decisions. As a further safeguard to the interests of the plaintiff class, Consumers Union provides the plaintiffs' attorney and intervenors with a semiannual report of its past and planned settlement-funded activities, as well as an annual audited statement of accounts.[190]

Another example of the consumer trust fund is the Virginia Environmental Endowment, created from $8 million of a $13.2 million fine assessed against Allied Chemical Corporation for pollution of the James River.[191] The purpose of the Endowment was to benefit the people of Virginia who were injured by the pollution. The board of trustees, selected by the court, has used interest on the money to fund projects such as chemical pollution research at the Medical College of Virginia, the ongoing Institute for Environmental Negotiation, and a related consumer publication.[192]

C. Criticisms of the Consumer Trust Fund

The consumer trust fund is subject to the same criticisms as cy pres mechanisms in general: the possibility of third-party windfall and double recovery, due process problems, and the courts' lack of equitable powers to authorize this type of distribution scheme. A criticism unique to the consumer trust fund, however, is the paternalism involved in determining how class members' money is used. This criticism is particularly strong when the entire fund is placed into trust, without paying individual claims. The California Attorney General has charged that advocates of the consumer trust fund "believe that a large sum of money in the hands of consumer advocates . . . is 'better' for consumers than cash in the *consumers*' hands."[193] The Attorney General further stated that "[i]ndividual options about whether to make a claim and how to use

190. Memo of Understanding, *supra* note 186, at 4-5.

191. Described in Brief for Amici Curiae, *supra* note 144, at 38-39.

192. *Id.* Other examples of trust-fund type distributions include: (1) A $25 million settlement, of which $5 million was used to fund a study on the long-term health effects of the Three Mile Island incident. *In re* Three Mile Island Litig., 557 F. Supp. 96, 97 (M.D. Pa. 1982), *discussed in* 2 H. NEWBERG, *supra* note 1, § 10.23, at 387 n.182; (2) the settlement of a hazardous waste enforcement action, which required that the defendant contribute $75,000 annually to California universities for environmental research. People v. Occidental Petroleum Corp., Civ. S-79-989 MLS (E.D. Cal. Feb. 4, 1981), *discussed in* Brief for Amici Curiae, *supra* note 144, at 40 n.35; and (3) a consumer antitrust suit alleging food retailer price fixing, in which the settlement terms provided that after seven years, any unexpended food allotments would be donated to charity. Ohio Pub. Interest Campaign v. Fisher Foods, 546 F. Supp. 1 (N.D. Ohio 1982), *discussed in* 2 H. NEWBERG, *supra* note 1, § 10.24, at 389 n.192.

193. Reply of Respondent State of California to Amici Curiae at 4, *Levi Strauss*, 41 Cal. 3d 460, 715 P.2d 564, 224 Cal. Rptr. 605 (No. SF24699) (emphasis in original).

one's own money . . . would be sacrificed to the [advocates'] view: we know what's best for you."[194] Arguments such as the Attorney General's, however, neglect a crucial point: the consumer trust fund is much more likely to provide lasting benefits for the injured class than a one-time distribution of a paltry sum, especially when managerial problems render compensation to all class members unlikely.[195]

D. Benefits of the Consumer Trust Fund

There also are benefits specific to the consumer trust fund. The consumer trust fund not only fulfills the goals of compensation, disgorgement of illegally obtained profits, and deterrence of unlawful conduct, but it is also cost effective and conserves judicial resources. Further, it is the most effective way to benefit all injured consumers, regardless of their socioeconomic status.[196]

A comprehensive study of the claims procedure used in the antibiotics litigation indicates that, in contrast to comparison populations, claimants tended to be middle-aged, well educated, well compensated, and employed in white-collar occupations, while minorities were underrepresented within the claimant group.[197] If minorities, blue-collar workers, the less educated, and the less affluent are not participating in claims for damage refunds in a representative manner, the goal of compensation requires that their rights, as well as the rights of those who submit claims, be considered.[198]

The consumer trust fund is uniquely suited to accomplish such a result. Funding projects in the public interest is the "next best" method of using the funds on behalf of these underrepresented groups who are less likely to file claims. The benefit to the underrepresented, although indirect, is also increased when the entire fund is placed in trust, because notice and administrative costs, which normally are paid out of the non-

194. *Id.* (footnotes omitted).

195. Such managerial problems occurred in the *Levi Strauss* litigation. *See supra* notes 163-73 and accompanying text. Counsel for intervenor pointed out that "[i]nstead of a one-time trivial return . . . every year the entire class . . . would benefit from the civil law enforcement efforts of an endowed private attorney general." Petition for Hearing, *supra* note 171, at 27. Counsel continued that "the residue of the fund would protect consumers from future price-fixing and other anticompetitive practices." *Id.* at 28.

196. *See generally* A CLASS ACTION SUIT THAT WORKED, *supra* note 2.

197. *See supra* notes 132-33 & 164 and accompanying text. The claimants were compared with (1) the United States household population age 18 and over as sampled by the National Opinion Research Center General Social Survey of March-April 1976 and (2) the population of California in 1970 as reported by the United States Census. *Id.* at xv, 80.

198. *See* Boeing Co. v. Van Gemert, 444 U.S. 472, 481-82 (1980) ("[M]embers of the class, whether or not they assert their rights, are at least the equitable owners of their respective shares in the recovery."); *see also* Frankel, *Amended Rule 23 from a Judge's Point of View,* 32 ANTITRUST L.J. 295, 299 (1966) (quoting Professor Ben Kaplan, Reporter of the new Rules, that the "historic mission" of the class action has been to take care of "the smaller guy").

claimants' share of the funds, are not incurred. A recent poll conducted by the University of Southern California's Institute on Government and Politics[199] revealed that, of the *Levi Strauss* class members polled, 65% approved of placing the remaining funds in a consumer trust fund, independent of governmental or business controls. Such widespread support for the consumer trust fund indicates that class members themselves appreciate the long-term benefits that can be derived from such use of residual funds.

The consumer trust fund also meets the goals of deterrence of future unlawful conduct and disgorgement of illegally obtained gains by the defendant.[200] Disgorgement of profits provides both a deterrent to defendants and compensation to injured plaintiffs. Thus, the consumer trust fund can be used either as a compensatory mechanism that applies residual funds to benefit the next best class or as the sole compensatory mechanism of the aggregate damages or settlement fund.[201]

Cost effectiveness is another benefit of both types of consumer trust funds, particularly when the entire aggregate recovery is placed in trust.[202] The costs of trustees or a board of advisors can be minimized, and the expenses of notice, claims solicitation and processing, and disbursal of the funds are avoided completely. As a result, more funds are available for projects to benefit consumers, including those who have been injured by the violation.[203]

Yet another benefit of the consumer trust fund is that judicial supervision is minimized because the class' counsel serves as a watchdog over the trustee's expenditures.[204] Moreover, the trustee is bound by a fiduciary duty to use the funds to the greatest possible benefit of the injured

199. A copy of the poll is on file with *The Hastings Law Journal.*

200. If the defendant settles without an admission of wrongdoing, the consumer trust fund nonetheless serves the purpose of disposing of the settlement funds to benefit injured class members.

201. When the defendants' total monetary liability to the class may properly be determined without individual proofs from class members, then if all members cannot be located or do not claim their proportional recovery, it is not possible to achieve fully the compensatory functions of the substantive cause of action that is being enforced in a class action format. However, the deterrence function of the underlying substantive cause of action can be achieved if the unclaimed residue of an aggregate class recovery is distributed indirectly for the benefit of class members under cy pres notions, or is escheated to the state government as unclaimed funds, or *is distributed in the sound discretion of the court to some other nonprofit, tax-exempt institution or organization serving the general public.*

2 H. NEWBERG, *supra* note 1, § 10.24, at 391 (emphasis added).

202. *See* Note, *An Economic Analysis, supra* note 3, at 179.

203. *See* Note, *Collecting Overcharges, supra* note 3, at 1054 (concluding that use of aggregate damage funds is more effective than small rebates to individual claimants).

204. Interview with Carl Oshiro, Director of Special Projects, Consumers Union of United States, Inc., West Coast Regional Office, Sept. 23, 1985.

consumers.[205] Consequently, after the consumer trust fund is established, the court need become involved again only if a disagreement among the parties arises or the trustee wishes to discontinue its role.[206]

Compared with other cy pres distribution mechanisms, the consumer trust fund, with few exceptions,[207] is the best method of achieving the ultimate goals of the cy pres doctrine and the consumer class action. The trustees' fiduciary duty to the injured class, their accountability to plaintiffs' counsel and the court, and the court's ability to intervene make the consumer trust fund a superior mechanism to governmental escheat, whether general or earmarked. The consumer trust fund is superior to claimant fund-sharing because it provides benefits that reach a greater number of class members, including those in lower socioeconomic groups who are less likely to submit claims. The trust fund also avoids the marketplace disruption caused by the price-reduction mechanism, and provides more tangible and durable benefits for injured consumers while advancing the public interest generally. Once the need for a cy pres distribution mechanism is established, the consumer trust fund will often be the most appropriate mechanism for furthering the goals of the consumer class.

IV. Conclusion

Settlement funds and damages often cannot be distributed to each injured member of a plaintiff class. Class members may fail to submit a claim, or the class representative may be unable to identify and locate each possible claimant. In some class actions, individual damages may be so paltry that the administrative cost of reimbursing the injured consumers is greater than the amount of recovery.

The cy pres doctrine, borrowed from the law of trusts, allows the funds to be used for a similar purpose when it is impossible or impractical to distribute the funds in a traditional manner. Of the four cy pres distribution mechanisms discussed—price reduction, escheat, claimant fund-sharing, and the consumer trust fund—the consumer trust fund achieves the cy pres purpose most closely. Each of the mechanisms contributes, in varying degrees, to the fundamental goals of disgorgement of unlawful profits, deterrence of future unlawful activity by the defendant,

205. *See supra* note 182 and accompanying text.

206. *See* Note, *An Economic Analysis, supra* note 3, at 179 & n.21.

207. As discussed earlier, other cy pres mechanisms may be more appropriate in a few situations. For example, if unlawfully assessed sales taxes are already in the state treasury, governmental escheat may be the appropriate disposition of those overcharges. *See supra* note 136 and accompanying text. Price reduction may be appropriate when a monopoly has engaged in unlawful overcharges. *See supra* note 151 and accompanying text. Claimant fund-sharing may be useful where the vast majority of class members submit claims. *See supra* note 155 and accompanying text.

and compensation of class members. At the same time, the cy pres distribution mechanisms have been subject to criticism.

One criticism of cy pres distribution mechanisms is that they may result in windfall to third parties or to the class claimants. Windfalls are allowed in several areas of the law, however, and they are a small shortcoming in light of the benefits of cy pres distribution and the available alternatives: reversion to the defendant or governmental escheat.

Others have challenged the courts' power to order cy pres remedies. Nonetheless, most jurisdictions do not prohibit cy pres distribution mechanisms, and many courts have been willing to fashion innovative remedies to further the goals of the substantive laws under which class actions are brought.

Other criticisms of cy pres distribution mechanisms concern due process and federal statutory constraints. The *Eisen III* court, in refusing to allow cy pres distribution under Federal Rule of Civil Procedure 23, was concerned with the Rules Enabling Act's prohibition on modifying substantive rights. It is unclear, however, that a mere distribution scheme can actually modify substantive rights, and the *Eisen III* court failed to balance the plaintiffs' interests and the underlying goals of class actions with the defendants' due process concerns.

Due process challenges particularly criticize the aggregation of damages for the entire class; defendants are not given the opportunity to contest the fact and amount of individual claims. Nonetheless, Federal Rule 23 and state class action statutes not only allow but anticipate that class suits may go forward without identifying each class member. Further, once damages are established, the defendant has no legitimate interest in how those damages are distributed.

Plaintiffs' due process concerns arise when they are unable to claim their individual recoveries from the pool of damages or settlement funds. If individual recoveries are substantial, however, it is unlikely that a court would apply a cy pres mechanism to the entire fund.

The alternative to cy pres distribution mechanisms—reversion to the defendant, reclassification of damage suits as injunctive suits, and congressional action—are fraught with difficulties and do little to advance class members' interests. Governmental escheat, one of the four cy pres distribution mechanisms examined here, is problematic whether or not the funds are earmarked for a specific purpose. If not designated for a specific purpose, the funds do little to further any class interest. Even if the funds are earmarked, it is difficult to ascertain whether the money is used for that purpose or whether the government has diverted existing funds from the earmarked program. Price reduction tends to benefit new customers more readily than the injured class members, and may disrupt the marketplace by making a wrongdoer's discounted product more attractive to consumers, thereby injuring his competitors. Claimant fund-

sharing rewards only class members who submit claims, which not only results in a monetary windfall to the claimants, but also ignores the rights of class members who fail to submit claims. Statistically, low-income minorities are underrepresented in the claimant group; thus claimant fund-sharing may ignore large portions of certain socioeconomic groups.

The consumer trust fund uses money remaining from consumer class actions to fund either existing private programs or new projects in keeping with the interests of the class. This mechanism allows much more control over the funds than is possible in governmental escheat, and avoids the market disruption of price-reduction plans. Unlike claimant fund-sharing, the consumer trust fund takes into account all class members, regardless of their socioeconomic status. Further, any windfall to claimants is not monetary, but takes the form of an increase in services or in protection of rights. In this era of governmental cutbacks and reluctance to finance public interest programs, the consumer trust fund allows money to be used to finance worthy programs in support of the plaintiffs' interests.

The consumer trust fund can be an ideal mechanism for distributing the residuum resulting from settlements or judicially created damages funds in consumer class actions. Although only federal and California courts have been examined here, all jurisdictions in which cy pres distribution mechanisms are not prohibited should exercise their equitable powers to allow consumer trust funds when undistributed funds remain or when each plaintiff's recovery is small. The trust fund is a cost-effective distribution method that serves the goals of compensation, disgorgement of unlawful profits, and deterrence of future illegal conduct. While certain issues must be considered on a case-by-case basis, such as the selection of the trustees, whether to invest the entire fund or only the residuum after payment of individual claims, and the particular guidelines for the types of projects to be funded, the consumer trust fund remains a flexible structure by which both statutory and public policies may be satisfied.

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